

NAVAL POSTGRADUATE SCHOOL MONTEREY, CALIFORNIA



THESIS

DOD PROFIT POLICY ITS EFFECTIVENESS--THE CONTRACTOR'S VIEW

by

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**DOD PROFIT POLICY
ITS EFFECTIVENESS -- THE CONTRACTOR'S VIEW**

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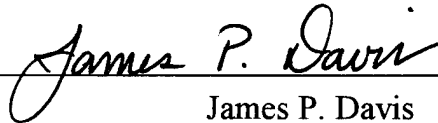
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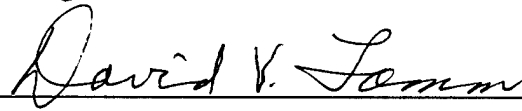
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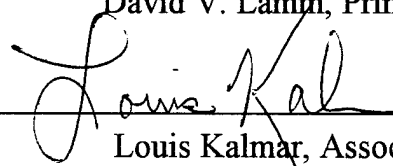
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ABSTRACT

The Federal Acquisition Regulation requires Government agencies to use a structured approach to determine prenegotiation profit objectives for those contracts requiring cost analysis. The structured approach utilized by the Department of Defense (DoD) is the Weighted Guidelines. This research sought to examine the effectiveness of the current Weighted Guidelines, as a vehicle for implementation of DoD profit policy, from the perspective of the defense industry. Industry opinions were solicited on a range of issues through use of a survey instrument. These issues included industry familiarity with the Weighted Guidelines, use of the Weighted Guidelines by industry to prepare for negotiations with the Government, value of profit policy and the Weighted Guidelines as incentives for firms to remain in the defense industrial base, and overall opinion of the Weighted Guidelines method. Respondent opinions were analyzed in detail, and conclusions and recommendations for improvement were presented.

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I. INTRODUCTION

A. GENERAL OVERVIEW

Over the last thirty-five years, several studies have been conducted to review the manner in which the Federal Government determines profit levels for defense contractors. Defense industry profitability is of great interest to Congress, the media, and the tax-paying public. Concerns over "profiteering" by defense manufacturers are nothing new, dating back to the Revolutionary War period. Yet, it is obviously in the Government's best interest to ensure that defense contractors are properly compensated for effective performance. These financial rewards are greatly influenced by profit policy. The current policy in use by the Department of Defense (DoD) was implemented on 01 August 1987. The policy is set forth in the DoD Federal Acquisition Regulation Supplement (DFARS), Part 215, Subpart 215.9. In accordance with the Federal Acquisition Regulation (FAR), the DFARS provides a structured approach for determining profit or fee objectives in acquisitions requiring cost analysis. This approach is known as the Weighted Guidelines (WGL). The goal of this policy is to:

- incentivize contractors to reduce costs by investing in capital-reducing equipment;

- reward contractors for taking on risk;
- motivate contractors to perform in the most efficient manner.

B. OBJECTIVES OF RESEARCH

The purpose of this research is to analyze the effectiveness of DoD's profit policy, specifically the Weighted Guidelines method of establishing profit objective, in incentivizing defense contractors to provide efficient and effective contract performance. This analysis is based on interviews with the defense industry. As Lester C. Thurow has noted, "the highest profits are to be found in producing the goods and services that potential buyers want most."

[Ref 13:p.64] This study will examine the connection between profit and performance by examining the perspective of the defense firms themselves. Do defense contractors feel they are being properly rewarded for producing the goods and services DoD wants?

C. SCOPE AND LIMITATIONS OF RESEARCH

The focus of the research will be limited to the effectiveness of the Weighted Guidelines in stimulating efficient and effective performance, as seen from the perspective of defense contractors and subcontractors. The

research is intended to evaluate current policy, focusing on industry opinion.

This research does not address actual profit levels experienced by the defense industry. The researcher made no attempt to conduct a statistical analysis of profit trends.

D. RESEARCH QUESTION

To achieve the stated objectives, the following primary research question is presented: To what extent does DoD's current profit policy, specifically the Weighted Guidelines method of determining profit objective, incentivize defense contractors to provide the most efficient and effective contract performance?

In support of the primary question, the following subsidiary questions were developed to help analyze the effectiveness of DoD's profit policy:

- How does the defense industry view the effectiveness of DoD's profit policy?
- Do defense contractors use the Weighted Guidelines method to prepare for negotiations? If not, why not?
- In an era of declining defense budgets, to what extent does DoD's profit policy provide an incentive to contractors to remain an active member of the defense industrial base?

E. RESEARCH METHODOLOGY

The methodology of the research consisted of two components: development of a literature base and interviews of defense contractors. The literature base was developed primarily with materials obtained via the Defense Logistics Studies Information Exchange (DLSIE) and the Dudley-Knox Library at the Naval Postgraduate School. Additionally, various journals and periodicals concerning Government acquisition were consulted.

This research was conducted to determine how members of the defense industry view DoD's profit policy, specifically the Weighted Guidelines. Questionnaires were sent to the Director of Government Contracts at 100 defense firms. The contractors were selected through use of Hoover's Handbook of American Business, Fortune magazine, and the 1994 Partners in Preparedness Directory in the May/June 1994 issue of National Defense magazine. The researcher targeted those firms known to have conducted business with DoD. Of the 100 surveys mailed, 48 were returned for a response rate of 48%. The questionnaire contained 27 yes-no, scaled, and open-ended questions. The questions were designed to elicit opinions on a wide range of issues related to industry's perception of, and experience with, DoD profit policy and the Weighted Guidelines. Average time to complete the questionnaire was

estimated at 10 to 15 minutes. Respondents were given the option of remaining anonymous, although they were encouraged to provide their names and phone numbers for follow-on questioning as necessary. In addition to questions concerning DoD's profit policy, respondents were asked questions regarding size of company, number of employees, amount of annual business with DoD, and the type of product or service provided.

F. ORGANIZATION OF THE STUDY

This study consists of six chapters. Chapter I contains an introduction to the scope, purpose and methodology of the research. The research questions, scope and limitations made in the research are described, with a brief literature review and the research methodology outlined to end the chapter. Chapter II provides a discussion of the theoretical structure of the research, including a review of the role of profit as an incentive and the evolution of Government profit policy. Chapter III contains the background and history of DoD's Weighted Guidelines method of establishing profit objective, and includes a detailed discussion of the current policy.

Chapter IV contains the results of the research questionnaires. Included in Chapter IV are the responses to each question, with a presentation of the results and their

numerical distribution. Chapter V provides an analysis of the results described in Chapter IV, as well as general observations made by the researcher in the course of the study.

Chapter VI provides conclusions formulated from the research of DoD's profit policy and provides recommendations for improvement. Additionally, all research questions are summarized and areas for further study are identified.

II. THEORETICAL STRUCTURE

A. INTRODUCTION

The Federal Government, when procuring goods and services, strives to purchase the highest quality items necessary to satisfy its requirements while paying the lowest possible price. In order for this process to occur, there must be commercial firms and manufacturers willing to deal with the Government. The Government, therefore, must provide an incentive. That incentive is profit. [Ref 13:p.64]

This chapter will present the theoretical structure that was used to conduct the research and analysis. It is designed to present the reader with a thorough understanding of the goals and evolution of current profit policy. The first section will provide a general overview of Government profit theory. Subsequent sections will discuss the role of profit as a motivator; the evolution of profit policy; and the various studies which have contributed to the development of the current policy. Familiarity with these topics will enhance the reader's understanding of the current environment.

B. GENERAL OVERVIEW

Traditionally, the Government has relied on the forces of the marketplace to establish contract prices. [Ref 16:p.4-1]

It is assumed that if a price is set by competition, it will by definition be fair and reasonable. The amount of profit achieved by the contractor depends on his ability to produce below the contract price. In these situations, cost analysis by the Government is not required. [Ref 16:p.4-1]

Under circumstances where competitive forces are absent, cost analysis is a must. As a part of this process, contractor profit is reviewed. The contracting officer must determine a fair and equitable profit level for the contractor, based on the circumstances of the individual contract. This is a critical step, due to the Government emphasis on profit as a contractor incentive:

It is the Government's belief that profit is the basic motivating force behind the contractor. There is an implied assumption on the part of the Government that the contractor will be properly motivated if given the opportunity to increase his profits. [Ref 22:p.47]

C. PROFIT AS A MOTIVATIONAL FORCE

Profit can be viewed from several perspectives. The accountant views profit in terms of numbers; profit (or net income) is simply calculated by deducting total expenses from total revenue. [Ref 12:p.16] In other words, "when a business

firm has paid all of its costs, what is left over is profit."

[Ref 7:p.298]

From an economist's perspective, manufacturers earn a return on their efforts by providing three productive inputs:

First, they are willing to delay their own personal gratification....They save some of today's income and invest those savings in activities that will yield goods and services in the future. When sold, these future goods and services will yield profits that can then be used to finance consumption or additional investment....Second, some profits are a return to those who take risks. Some investments make a profit and return what was invested plus a profit, but others don't....On average, those who take risks will earn a higher rate of return on their investments than those who invest more conservatively....Third, some profits are a return to organizational ability, enterprise, and entrepreneurial energy. The entrepreneur, by inventing a new product or process, or by organizing the better delivery of an old product, generates profits. [Ref 13:p.64]

As discussed above, the Government sees profit as the prime motivator for contractors. Is this the case? As Gerald T. Nielsen has indicated, "most business oriented decision makers today have been so ingrained with the principles of profit maximization that the concept seems almost intuitively obvious." [Ref 11:p.22] Additionally, Dr. Peter Drucker notes:

...production for profit is the principle of rationality and efficiency on which the corporation must base itself...and the demand that some

criterion other than profitability be used as a determinant of economic actions rests on a misunderstanding of the economic process.
[Ref 5:pp.231-232]

The view of the defense industry toward profit is also reflected by the remarks of Roy A. Anderson of the Aerospace Industries Association, made before the House Armed Services Committee in 1988:

Reasonable profits, not excessive profits, are good for the defense industry and our nation. Reasonable profits invite competition, broaden the industrial base, provide stimulus for investment in research and development and attracting and retaining technical personnel so essential to maintaining this nation's technology leadership. Profits are necessary for investment in capital equipment to increase productivity and reduce costs, and serve as the base for investment and financing. [Ref 2:p.35]

It makes sense that, in a capitalistic society, contractors are driven by profit. However, there are other factors to consider as well. These include the firm's strengths and weaknesses, the competitive environment, the health of the industrial base and the goals of the firm:

Contractors do not necessarily seek maximum profit on every contract. There do exist other motivational forces, such as concerns for follow-on business, growth opportunities, or improvement of corporate image. [Ref 15:p.195]

A study by the Logistics Management Institute (LMI) in the late 1960s made several interesting points about the role of profit in the defense industry [Ref 9:p.8]:

There is virtually unanimous agreement among managers and analysts who have studied overall contractor motivation that, in the short run, contractor management does sacrifice short run profit on defense business in favor of achieving:

1. Company growth;
2. Increased industry market share;
3. A better public image;
4. Organizational prestige;
5. Benefits to commercial business;
6. Greater opportunity for follow-on business;
7. Shareholder expectations.

In summary, the LMI study concluded that management

...does not attempt to maximize profit or fee on individual contracts. It attempts to optimize among many objectives, placing particular stress on those which contribute most to maintaining or improving market position and assuring the future strength of the firm. [Ref 9:p.9]

It seems clear that many factors motivate contractor performance and influence management decisions. However it seems equally clear that without adequate profits firms will

not long survive, particularly in an era of reduced defense spending. In the long run, the profit motive must be satisfied before contractors focus on other concerns.

D. EVOLUTION OF PROFIT POLICY

In the early part of our nation's history, the focus on price competition prevented the need for a formal profit policy. However, defense procurement was not without its problems. "Allegations of excessive profits can be traced back to the Revolutionary War." [Ref 14:p.915] By 1809, Government statutes required purchasing officers to advertise for competitive bids for the procurement of defense goods. [Ref 10:p.6] During the Civil War, the Civil Sundry Appropriations Act of 1861 formalized bidding procedures but made allowance for negotiated procurement. This Act remained the basic procurement statute for nearly 100 years.

During World War I, war profiteering again became a concern. During this period, many unique military items were bought using cost-plus-a-percentage-of-cost contracts. This approach to contracting resulted in such abuses that "during the period between the wars, Congress considered 200 bills and

resolutions aimed at controlling war profits and improving the purchasing system." [Ref 3:p.28]

The attention to war profiteering eventually led to the enactment of the Vinson-Trammell Act of 1934. The Vinson-Trammell Act

...limited profits on military aircraft prime and subcontracts to 12% of the price, and on naval prime and subcontracts to 10% of the price. The latter limitation was also included in the Merchant Marine Act of 1936. [Ref 14:p.915]

In 1939, the Vinson-Trammell Act was amended to raise the profit rate on naval contracts to 12%.

In the early days of World War II, Congress responded to the national crisis by passing the First War Powers Act of 1941. This Act

...gave the president the authority to empower federal agencies to enter into contracts without regard to existing legislation if they facilitated the war effort. Additional actions by the president and the War Production Board would authorize negotiated contracts in lieu of complying with formal advertising statutes, and finally prohibit formal advertising totally. [Ref 10:p.8]

With the massive mobilization of national industry during the war, the prospect of profiteering again became an issue. The Renegotiation Act of 1942 called for the renegotiation of both prime and subcontracts in excess of \$100,000 and made

possible the recovery of excess profits. [Ref 22:p.50] Under this Act, the Government was authorized to redetermine a fair and reasonable profit on a contract-by-contract basis after delivery of the products. Determination of reasonable and excessive profits in defense awards was based on such factors as contribution to the war effort, efficiency, and extent of risk assumed. [Ref 14:p.915] The Renegotiation Act was modified in 1951, transferring administration of this statutory profit limitation to an independent Renegotiation Board. The final Renegotiation Act of 1951 was extended 13 times and lasted until September 30, 1976. [Ref 14:p.915]

After World War II, the Armed Services Procurement Act (ASPA) of 1947 supplanted the Civil Sundry Appropriations Act of 1861 as the principal statute governing defense procurement. The Department of Defense (DoD) implemented the ASPA through the Armed Services Procurement Regulation (ASPR), which provided DoD's first formalized policy statement on profit:

The Department of Defense must apply contracting policies and methods designed to create an environment in which industry can realize profits on defense business which are high enough to give reasonable assurance of long term availability to DoD of industrial support by the best companies and to enable those defense contractors to attract sufficient equity and borrowed capital. [Ref 22:p.51]

The ASPR lacked specific guidance for the contracting officer to use in developing profit objectives for negotiated contracts. Eventually, over the course of the decade of the 1950s, nine profit elements were identified:

- Effective competition;
- Degree of risk;
- Nature of work to be performed;
- Extent of Government assistance;
- Extent of contractor investment;
- Character of contractor's business;
- Contractor performance;
- Subcontracting; and
- Unrealistic estimates.

Lacking specific guidance, contracting personnel were forced to subjectively evaluate each element and the weight to be accorded. The predominant factor was the "historical rate" established on previous contracts. "Contracting officers used the above nine profit elements only to adjust profit rates to fit specific procurement situations." [Ref 22:p.52] Inadequacies in this policy led to continued Congressional and public concerns over excessive defense profits. Clearly, a new approach was needed.

E. THE LOGISTICS MANAGEMENT INSTITUTE STUDY

In an effort to develop a more structured approach to determination of prenegotiation profit objectives, in 1963 DoD commissioned the Logistics Management Institute (LMI) to conduct a detailed study of profit policy and recommend improvements. The objective of this study was

...to develop a rational, workable, uniform and equitable approach to target profits which will result in a wider range of profits. The study aims to develop specific guidelines to assist contracting personnel in arriving at appropriate profit ratios to further national and departmental interests utilizing the profit motive of DoD contractors. [Ref 3:p.31]

Essentially, the LMI study found that [Ref 3:pp.31-32]:

- Government contracting personnel were using the profit or fee rate established under previous contracts as a price determinant for negotiation of new contracts;
- contractor investment was not being used to determine fee or profit;
- contractor investment was often a criterion used in the source selection process, but was not used in negotiations.

Based on the conclusions of the LMI study, DoD implemented the original Weighted Guidelines (WGL) on 01 January 1964. The WGL was a more structured approach designed

to allow contracting personnel to develop profit objectives consistent with the circumstances of each contract. The new approach was based on the concept that profit

...should depend on the risk assumed by the contractor, the difficulty of the task, the amount of contract cost, the source of resources, contractor past performance and other factors [Ref 18:p.V-1]

Under this approach, the contracting officer "would select a specific profit rate from a range provided by the guidelines." [Ref 21:App.I, p.6] The new policy, while more structured, still depended heavily on the subjective determination of contracting personnel. The WGL were also criticized for failing to properly recognize contractor investment, and depending too heavily on estimated cost as a basis for determining profit objectives.

DoD continued to be interested in promoting contractor investment. In order to determine the effects of the new WGL approach, DoD in 1967 again commissioned LMI to perform a study of its profit policy. LMI determined that the WGL had in fact provided contractors a negative incentive to invest in new facilities and equipment. The study concluded that

...the Weighted Guidelines provided incentives for the contractor not to invest in cost reducing plant and equipment but to allow costs to escalate....LMI recommended that the weighted guidelines be

expanded to allow profit objectives to be determined by costs and assets applied. The proposed solution went on to state that the assets to use in determining profit should be operating and facilities capital. [Ref 3:p.35]

As a further analysis of the results and impact of the Weighted Guidelines, a RAND Corporation study in 1969 concluded that [Ref 15:pp.256-257]:

- Most firms had higher target fee rates after introduction of the Weighted Guidelines approach, but average realized fee rates appear to have remained about the same.
- The Weighted Guidelines method resulted in spreading the distribution of going-in target fee rates.
- The objective was achieved, if the goal of the method was to increase profit opportunities, regardless of whether or not they were achieved, by providing higher levels of target fees.
- The goal was achieved, if the goal was to provide a wider distribution of average fees.
- The goal was not achieved, if the goal was to increase actual fees rather than target fees.
- Results appear to have been mixed and on the whole unsuccessful, if the goal was to raise the profitability of defense investment.

Further studies indicated that the Weighted Guidelines were not providing contractors with incentives to invest in cost-reducing equipment. This was primarily due to the WGL approach of linking profits to costs. A 1971 General

Accounting Office (GAO) study noted that, "under the current system of negotiating contract prices, such investments tend to lower, rather than increase, profits in the long run." [Ref 3:p.36]

In an attempt to remedy the problem of contractor investment, DoD developed a policy on contractor capital employed in 1972. This new policy was published in Defense Procurement Circular (DPC) 107, which established a method to base profit on return on investment. It provided that "50% of the profit would be based on the contractor's facilities and operating capital investment." [Ref 4:p.8] DPC 107 was optional, based on agreement between the Government and the contractor. The policy was largely unsuccessful; little used and apparently too complex, DPC 107 was phased out in 1975.

F. PROFIT '76

In view of continued criticism of its profit policy and the Weighted Guidelines, DoD launched a massive study of defense industry profitability and the health of the defense industrial base. This study became known as Profit '76. The purpose of the study was twofold [Ref 19:p.I-2]:

- to determine defense contractors' profit on both defense and non-defense business.

- to examine the relation of earnings to capital investment in assets designed to increase productivity and lower costs.

Cost and investment data from companies holding defense contracts valued at over \$16 billion were gathered for the study. In addition, surveys were conducted of Government procurement personnel, industry representatives and financial institutions. The study focused on those DoD policies which "govern or impact the profitability, capital investment policies, and overall financial condition of defense contractors." [Ref 19:p.I-4]

Profit '76 concluded that DoD's profit policy suffered from two primary problems [Ref 19:p.i]:

- overemphasis in the Weighted Guidelines on estimated cost as a profit factor.
- the absence of contractor investment as a meaningful profit determinant.

Based on the results of Profit '76, DoD revised its profit policy, which was released as Defense Procurement Circular (DPC) 76-3, effective 01 October 1976. Several important changes were included [Ref 19:pp.VII-6,7]:

- The imputed cost of capital for facility investment (cost of money measured in accordance with Cost Accounting Standard 414) would be considered allowable on most negotiated DoD contracts.

- The level of facility investment would be recognized by DoD contracting officers in reaching a pre-negotiation profit objective under the Weighted Guidelines method.
- Contract estimated cost received less emphasis as a profit determinant.
- A greater spread in profit was established to recognize the difference in risk between cost-reimbursement and fixed-price type contracts.
- Productivity improvements were introduced as a modest profit factor so as to further the principle that reduced costs will lead to increased earnings.
- Past performance as a profit determinant was deleted from the Weighted Guidelines.

With the new policy, DoD sought to maintain the viability of the defense industrial base by ensuring defense contractors the opportunity to earn adequate profits on defense contracts, as well as providing a positive incentive to invest in cost-reducing, increased efficiency facilities.

G. 1979 GENERAL ACCOUNTING OFFICE STUDY

In March of 1979, the General Accounting Office (GAO) released the results of a study assessing the effectiveness of the first 18 months of DPC 76-3. This study concluded that [Ref 20:p.5-9]:

- There was little indication that DoD's objective of encouraging contractors to invest in new or upgraded plant and equipment in order to lower production costs was being achieved.
- Prenegotiation profit objectives were still based primarily on cost rather than facilities investment.
- There were indications the new policy had resulted in the negotiation of higher profit rates on an overall basis.

As a result of GAO's findings, DoD again revised its policy. The new guidance was published in 1980 as Defense Acquisition Circular (DAC) 76-23, and contained two major changes [Ref 14:p.919; Ref 8:p.56]:

- Profit for facilities capital investment was increased from a 6-10% range to a 16-20% range, increasing this factor's percentage of total profit from 10% to 17%.
- The Weighted Guidelines were modified to provide separate profit weight ranges for manufacturing, research and development, and service contracts.

In the continuing effort to evaluate DoD's policy, the Air Force Systems Command conducted yet another study, Profit '82. [Ref 4:pp.13-14] This study was designed to assess the relevance of the current policy and the success of the changes made under DPC 76-3 and DAC 76-23. In summary, Profit '82 found that despite the changes discussed above, DoD profit policy was still not rewarding contractor capital investment,

nor was it providing motivation to invest. According to the Air Force research, during the period 1977-1981, capital investment on defense contracts as a percentage of total contract costs did not change. Additionally, the study found that DoD's policy lacked credibility within industry. [Ref 4:pp.13-14]

H. DEFENSE FINANCIAL AND INVESTMENT REVIEW

In 1983 DoD commissioned another massive study, the Defense Financial and Investment Review (DFAIR). The goal of DFAIR was to recommend "changes to contract pricing, financing and profit policies." [Ref 14:p.919] This study was conducted with the cooperation of selected Government officials, professional and industry associations, the Logistics Management Institute, and accounting firms.

Released in August 1985, DFAIR concluded that

...in general, the current contract pricing, financing and markup (profit) policies are (1) balanced economically, (2) protecting the interests of the taxpayer, and (3) enabling U.S. industry to achieve an equitable return for its involvement in defense business. [Ref 21:p.9]

Additionally, DoD concluded from the DFAIR study that its profit policy had resulted in a .5 to 1 percent unintended increase in profit objectives. Among DFAIR's recommendations

were the cancellation of DAC 76-23, upon which the increased profits were blamed, and revision of the Weighted Guidelines such that average profits would be reduced by .5 to 1 percent. Based on these conclusions and recommendations, DoD issued a revised, interim profit policy on September 18, 1986. Congress mandated adoption of the new policy under P.L. 99-500, enacted October 18, 1986; DoD was directed to make certain additional changes before issuing its final rule. This final rule, a complete revision of Defense Federal Acquisition Regulation Supplement (DFARS) Subpart 215.9, was issued on August 3, 1987, effective August 1, 1987. [Ref 14:pp.916-920]

I. SUMMARY

The purpose of this chapter has been to provide an understanding of the Federal Government's traditional position on profit, an examination of the role of profit as a motivator for the private sector, and a brief review of the evolution of DoD profit policy. The next chapter will discuss the current policy, specifically the Weighted Guidelines, in detail.

III. BACKGROUND

A. INTRODUCTION

In this chapter the current DoD policy, specifically the Weighted Guidelines, will be described in detail. Included is a review of the factors to be considered by the contracting officer when developing profit objectives. The chapter will close with a sample calculation of a profit objective in order to demonstrate use of the Weighted Guidelines.

B. THE GOVERNMENT'S POLICY

The profit policy of the Federal Government is set forth in the Federal Acquisition Regulation (FAR):

It is in the Government's interest to offer contractors opportunities for financial rewards sufficient to (1) stimulate efficient contract performance, (2) attract the best capabilities of qualified large and small business concerns to Government contracts, and (3) maintain a viable industrial base.

Both the Government and contractors should be concerned with profit as a motivator of efficient and effective contract performance. Negotiations aimed merely at reducing prices by reducing profit, without proper recognition of the function of profit, are not in the Government's interest. [Ref 6:p.15-37]

In addition, the FAR requires use of a structured approach for determining profit or fee objectives in acquisitions requiring cost analysis. DoD has established the Weighted Guidelines as the structured approach to be used for defense contracts. [Ref 17:p.215.9-1]

C. THE WEIGHTED GUIDELINES

The Defense Federal Acquisition Regulation Supplement (DFARS) Part 215, Subpart 215.9, describes the Weighted Guidelines (WGL) method to be used by DoD contracting personnel. The WGL are to be used in all negotiated contract actions requiring cost analysis, with certain exceptions identified by the DFARS. These exceptions are beyond the scope of this research.

When performing cost analysis, DoD contracting officers will develop a prenegotiation profit objective. The profit objective is designed to [Ref 16:p.4-2]:

- reward contractors that take on the more difficult tasks requiring higher skills.
- encourage contractors to accept greater contract cost responsibility by establishing substantially different profit levels for different pricing arrangements and different cost-risk situations.
- encourage contractors to make cost-effective capital investments.

- encourage contractors to use nongovernment resources.

In order to determine the prenegotiation profit objective, contracting officers use the DD Form 1547, Record of Weighted Guidelines Method Application. The DD 1547 [Ref 17:p.215.9-2]:

- provides a vehicle for performing the analysis necessary to develop a profit objective;
- provides a format for summarizing profit amounts subsequently negotiated as part of the contract price; and
- serves as the principal source document for reporting profit statistics to DoD's management information system.

The contracting officer also uses DD Form 1861, Contract Facilities Capital Cost of Money, to "report the facilities capital cost of money negotiated and to partially develop the facilities capital employed portion of the prenegotiation profit objective." [Ref 1:p.74]

D. THE WEIGHTED GUIDELINES METHOD

The Weighted Guidelines (WGL) focus on three primary profit factors: (1) Performance Risk; (2) Contract-type Risk; and (3) Facilities Capital Employed. When developing a

prenegotiation profit objective, the contracting officer will assign a value to each profit factor. The values assigned by the contracting officer are based on a range of values designated for each profit factor. Each profit factor has a normal value which represents "average conditions on the prospective contract when compared to all goods and services acquired by DoD." [Ref 17:p.215.9-3] Additionally, a range of values is available for assignment under conditions the contracting officer determines to be above or below normal.

E. PERFORMANCE RISK

This profit factor addresses "the contractor's degree of risk in fulfilling the contract requirements." [Ref 17:p.215.9-3] This factor consists of three elements:

- Technical -- the technical uncertainties of performance.
- Management -- the degree of management effort necessary to ensure that contract requirements are met.
- Cost control -- the contractor's efforts to reduce and control costs.

For each of these elements, the contracting officer will assign a percentage weight based on its effect on total performance risk. These three weights must total 100%. The

contracting officer will then select a value for each element from the available range of values. The assigned value is multiplied by the element's weight, yielding a weighted value for each element. The three weighted values of Technical, Management, and Cost Control are then added to determine a composite value for Performance Risk. [Ref 17:p.215.9-4]

The range of values available for assignment under Performance Risk is as follows [Ref 17:p.215.9-5]:

<u>Normal value</u>	<u>Designated range</u>
4%	2% to 6%

The contracting officer will review the following critical performance elements when determining the value to assign to the Technical element [Ref 17:p.215.9-5]:

- Technology being applied or developed by the contractor;
- Technical complexity;
- Program maturity;
- Performance specifications and tolerances;
- Delivery schedules; and
- Extent of a warranty or guarantee.

The contracting officer may assign a higher than average value if he determines that the subject contract poses a significant amount of technical risk. Technical risk is increased if the

contractor is developing or applying advanced technologies, if the effort requires highly skilled personnel or if the work requires the use of state of the art machinery. Technical risk is also increased if the contractor must meet strict tolerance limits or exacting standards, or if the effort is for a new or highly complex item. [Ref 17:p.215.9-5]

The contracting officer may assign a lower than average value if the acquisition is for off-the-shelf items, the requirements are simple, the technology involved is not complex, the effort is routine, or a mature program is involved. [Ref 17:p.215.9-6]

The contracting officer will examine the below factors when determining the values to assign to the Management element [Ref 17:p.215.9-6]:

- The contractor's management and internal control systems.
- The management involvement expected on the contract action.
- The degree of cost mix as an indication of the types of resources applied and value-added by the contractor.
- The contractor's support of Federal socioeconomic programs.

The contracting officer may assign a higher than normal value if he determines that the required management effort is

intense. A high degree of value-added effort by the contractor, a high level of coordination and active participation in Federal socioeconomic programs can lead the contracting officer to assign a higher than normal value. [Ref 17:p.215.9-6] A below normal value may be assigned if management efforts are minimal, such as in mature programs or contracts requiring routine efforts. Low values may also be assigned if the contractor provides proposals which are untimely or are of poor quality, fails to provide an adequate analysis of subcontractor costs, or possesses unsatisfactory management and internal control systems. [Ref 17:pp.215.9-6,7]

The contracting officer will evaluate the below factors when determining the values to assign to the Cost Control element [Ref 17:p.215.9-7]:

- The expected reliability of the contractor's cost estimates;
- The contractor's cost reduction initiatives;
- The adequacy of the contractor's management approach to controlling cost and schedule; and
- Any other factors which affect the contractor's ability to meet the cost targets.

The contracting officer may assign a higher than normal value if a contractor demonstrates a highly effective cost control program. This includes contractors who provide fully

documented and reliable cost estimates, possess an aggressive cost reduction program, utilize a high degree of subcontractor competition, and have a proven track record of cost tracking and control. [Ref 17:p.215.9-7] The contracting officer may assign a lower than normal value in situations where the contractor's cost estimating system is marginal, the contractor has made minimal effort to initiate cost reduction programs, or the contractor has a record of cost overruns or other indication of unreliable cost estimates and lack of cost control. [Ref 17:p.215.9-8]

F. CONTRACT TYPE RISK

The Contract Type risk factor focuses on the degree of cost risk accepted by the contractor under various contract types. [Ref 17:p.215.9-8] Included is a working capital adjustment added to the profit objective for Contract Type risk. This working capital adjustment only applies to fixed-price contracts which provide for progress payments.

The range of values available for assignment under Contract Type risk is as follows (the WGL does not apply to Cost-plus-award-fee contracts) [Ref 17:p.215.9-9]:

<u>Contract type</u>	<u>Normal value</u>	<u>Designated Range</u>
Firm fixed-price, no financing	5%	4% to 6%
Firm fixed-price with financing	3%	2% to 4%

Fixed-price incentive, no financing	3%	2% to 4%
Fixed-price, redeterminable (Treat as FPI/below normal)		
Fixed-price incentive with financing	1%	0% to 2%
Cost-plus-incentive-fee	1%	0% to 2%
Cost-plus-fixed-fee	.5%	0% to 1%
Time-and-material contracts	.5%	0% to 1%
Labor hour contracts	.5%	.0% to 1%
Firm fixed-price (Level of effort)	.5%	0% to 1%

When determining the value to be assigned, the contracting officer should consider the factors which may affect contract type risk. These factors include the length of the contract, adequacy of cost data, economic environment, nature and extent of subcontracts, and the protection provided to the contractor under contract provisions, such as economic price adjustment clauses. [Ref 17:p.215.9-9]

As with Performance risk, the contracting officer may assign above or below normal values. If the contracting officer feels there is substantial contract type risk, he may assign a higher than a normal value. Conditions which may increase contract type risk include efforts with minimal cost history, long-term contracts without provisions protecting the contractor, or incentive provisions which place a high degree of risk on the contractor. [Ref 17:p.215.9-10] The contracting officer may assign a below normal value if he determines the contract type risk is low. Conditions which

may reduce contract type risk include very mature product lines with an extensive cost history, short-term contracts, contracts with provisions that substantially reduce the contractor's risk, or incentive provisions which place a low degree of risk on the contractor. [Ref 17:p.215.9-10,11]

For those contracts under which the Government provides progress payments, the contracting officer must calculate the working capital adjustment. This calculation is made by multiplying the amount of costs financed by a contract length factor and an interest rate established by the Secretary of the Treasury. The contract length factor is the period that the contractor has a working capital investment in the contract. It is based on the time necessary for the contractor to complete the substantive portion of the work. This period is not necessarily the time between contract award and final delivery, and should not include contract option periods or, for multi-year contracts, the period of performance beyond the initial year's requirements. [Ref 17:p.215.9-12]

The contracting officer should use the following table to determine the contract length factor [Ref 17:p.215.9-12]:

<u>Period to perform substantive portion (months)</u>	<u>Contract length factor</u>
21 or less	.40
22 to 27	.65
28 to 33	.90
34 to 39	1.15
40 to 45	1.40
46 to 51	1.65
52 to 57	1.90
58 to 63	2.15
64 to 69	2.40
70 to 75	2.65
76 or more	2.90

If multiple deliveries are scheduled, the contracting officer may develop a weighted average value for contract length. [Ref 17:p.215.9-12]

G. FACILITIES CAPITAL EMPLOYED

Facilities Capital Employed (FCE) focuses on motivating contractors to invest capital in facilities that benefit DoD. This factor recognizes both the facilities capital employed in contract performance and the contractor's commitment to improving productivity. [Ref 17:p.215.9-12]

The three elements considered under Facilities Capital Employed are land, buildings and equipment. The contracting officer will consider the book value of these facilities, as well as a contractor's formal investment plan if the

contractor demonstrates DoD will realize benefits from the investment. [Ref 17:p.215.9-13]

The contracting officer will select values for land buildings and equipment from the following list [Ref 17:p.215.9-13]:

<u>Asset type</u>	<u>Normal value</u>	<u>Designated Range</u>
Land	0%	N/A
Buildings	15%	10% to 20%
Equipment	35%	20% to 50%

For highly facilitized firms performing research and development or service contracts, the contracting officer will choose from the following range of values [Ref 17:p.215.9-13]:

<u>Asset type</u>	<u>Normal value</u>	<u>Designated Range</u>
Land	0%	N/A
Buildings	5%	0% to 10%
Equipment	20%	15% to 25%

When considering the values assigned to FCE, the contracting officer must evaluate the potential benefits to DoD. He should review the usefulness of the facilities capital to the instant contract and analyze the improvement to productivity and other industrial base benefits resulting from the investment. [Ref 17:p.215.9-14]

If the contracting officer determines the capital investment has direct, identifiable and exceptional benefits, he may assign higher than normal values. Factors which benefit DoD include new investments in state-of-the-art technology which reduce cost or improve product quality, or investments over and above the normal capital necessary to support DoD programs. [Ref 17:p.215.9-14] The contracting officer may also assign lower than normal values if the capital investment provides little benefit to DoD. This includes situations in which the contractor's capital investment applies primarily to commercial production, the investments are for furniture, fixtures or offices, or the facilities used are old or extensively idle. [Ref 17:p.215.9-15]

Once the contracting officer determines the values to be used, these figures will be multiplied by dollar values assigned to land, buildings and equipment. These dollar figures are derived from calculations made by the contracting officer using DD Form 1861, Contract Facilities Cost of Money. For the purposes of the study, the use of DD Form 1861 will not be discussed.

H. CALCULATION OF PROFIT OBJECTIVE

In order to illustrate the use of the Weighted Guidelines in determining prenegotiation profit objective, the following example calculation is provided:

The following values represent costs proposed by the contractor:

	<u>Objective</u>
Material	\$20,000
Subcontracts	\$15,000
Direct Labor	\$700,000
Indirect Expenses	\$950,000
Other Direct Charges	\$40,000
Subtotal	<u>\$1,725,000</u>
General & Administrative	\$275,000
Total costs	<u>\$2,000,000</u>

The contracting officer made the following calculations for Performance Risk:

	<u>Assigned Weight</u>	<u>Assigned Value</u>
Technical	40%	5.0
Management	30%	4.0
Cost Control	30%	<u>4.0</u>
Performance Risk composite		4.4

The composite value of 4.4 will be multiplied by the base to determine a profit objective for Performance Risk:

$$4.4\% \times \$1,725,000 = \$75,900$$

For Contract Type Risk the contracting officer will multiply the assigned value, in this example 3.5%, by the base to determine profit objective for this element:

$$3.5\% \times \$1,725,000 = \$60,375$$

Next is the working capital adjustment:

<u>Costs financed</u>	<u>Length factor</u>	<u>Interest rate</u>	<u>Objective</u>
\$500,000	.65	7.625%	<u>\$29,738</u>

The contractor Facilities Capital Employed (FCE) objective is then calculated as follows:

	<u>Assigned Value</u>	<u>Amount employed</u>	<u>Objective</u>
Land	0%	\$6,000	---
Buildings	10%	\$100,000	\$10,000
Equipment	35%	\$400,000	\$140,000
Total FCE objective			<u>\$150,000</u>

The total profit objective is:

Performance Risk objective	\$75,900
Contract Type Risk objective	\$60,375
Working Capital Adjustment	\$29,738
Total FCE objective	<u>\$150,000</u>

TOTAL PROFIT OBJECTIVE **\$315,653**

The proposed profit rate is then determined:

Total cost	\$2,000,000
Facilities Capital	
Cost of Money (DD 1861)	\$40,000
Profit objective	<u>\$315,653</u>
Total price	<u>\$2,355,653</u>

$(FCCOM + \text{Profit objective}) / \text{Total cost} = \text{Profit rate}$

$(40,000 + 315,653) / 2,000,000 = 17.78\%$ Profit rate

Once the contracting officer has determined the profit rate and profit objective, he will use these figures during negotiations with the contractor. The profit objective determined through the use of the Weighted Guidelines is

intended to be a guide for the contracting officer, not a mandatory figure. It is a starting point upon which to base negotiations. Additionally, contractors are encouraged to develop their own profit objectives using the Weighted Guidelines. The goal is to enable the contractor to have a better understanding of the Government position. The Government also encourages contractors to use the Weighted Guidelines method to develop profit objectives for negotiating subcontracts. [Ref 17:p.215.9-2]

I. SUMMARY

This chapter has explained the Federal Government's position on profit, described in detail the Weighted Guidelines method, and illustrated the use of the Weighted Guidelines through use of a basic example. The following chapter will describe results of a defense industry survey on the Weighted Guidelines.

IV. DESCRIPTION OF DATA COLLECTED

A. OVERVIEW

In an effort to determine the opinions of defense contractors about DoD profit policy and the Weighted Guidelines, a questionnaire was sent to 100 companies. The questionnaire and associated cover letter is included as Appendix A.

Of the 100 questionnaires mailed, 48 were returned, representing a 48% return rate. Of the 48 respondents, three failed to correctly complete the questionnaire; their responses are excluded from the analysis. Additionally, phone interviews were held with representatives of several contractors. The results are included herewith.

B. DEMOGRAPHIC INFORMATION

Questions 1-6 were designed to provide demographic data on the respondents, including type of firm, amount of annual business with DoD, and number of employees. These data were used to identify trends within demographic groups.

Question #1:

Your firm is primarily a: (A) prime contractor; or (B) subcontractor.

The majority of respondents identified themselves as prime contractors, as is shown in Figure 1.

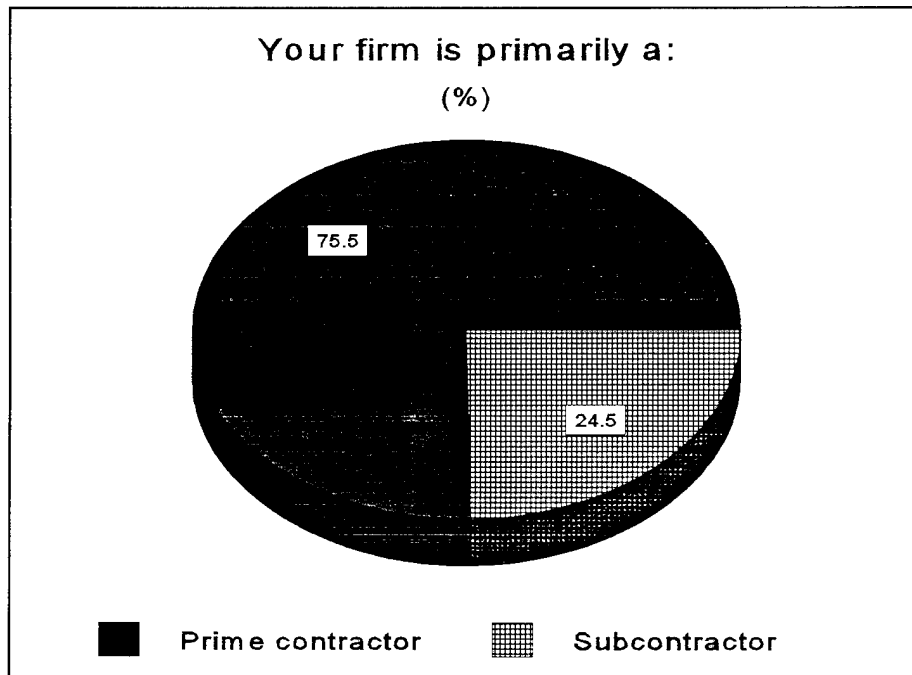


Figure 1. Responses to Question #1

Question #2:

Amount of annual business with DoD:

The majority of respondents indicated a minimum of \$1 million of business conducted annually with DoD, as shown in Figure 2. The largest number of respondents, 31.1%, perform over \$100 million in work.

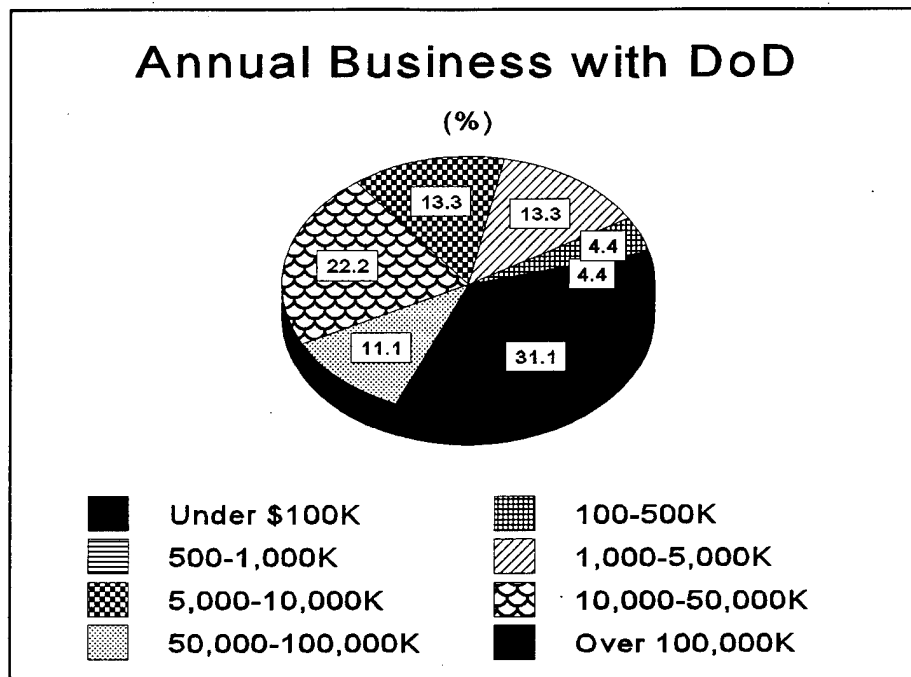


Figure 2. Responses to Question #2

Question #3:

Number of employees:

Those firms responding had a fairly even distribution of employee levels, as shown in Figure 3.

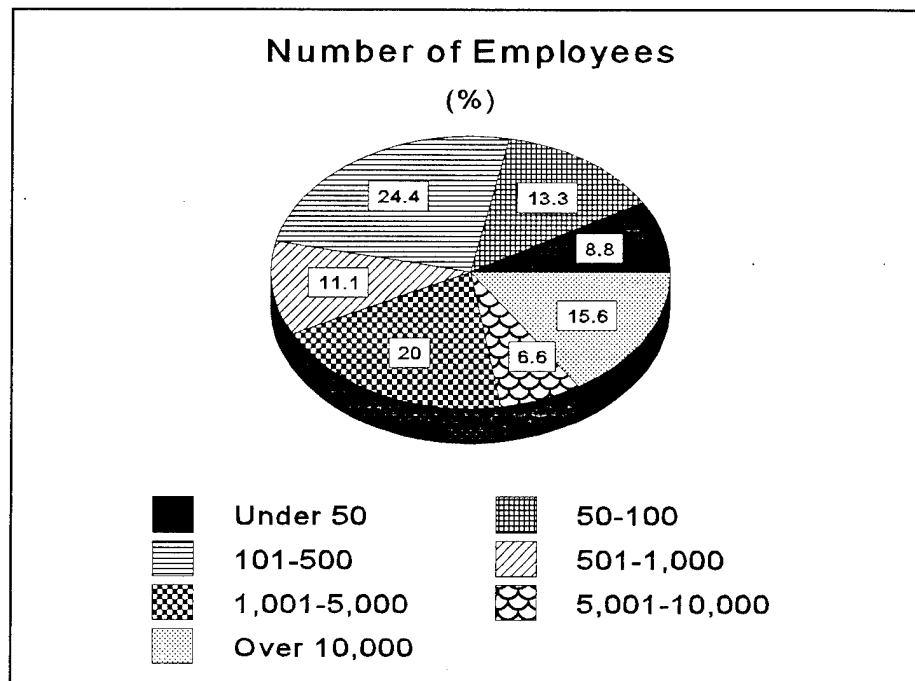


Figure 3. Responses to Question #3

Question #4:

Your primary Standard Industrial Classification (SIC) Code, if known:

Fifteen respondents provided their SIC codes; a complete listing of the responses is provided in Appendix B.

Question #5:

Percentage of your work which is sole source/non-competitive:

The percentage of sole source or non/competitive work performed by the respondents was distributed very evenly among possible responses, as shown in Figure 4.

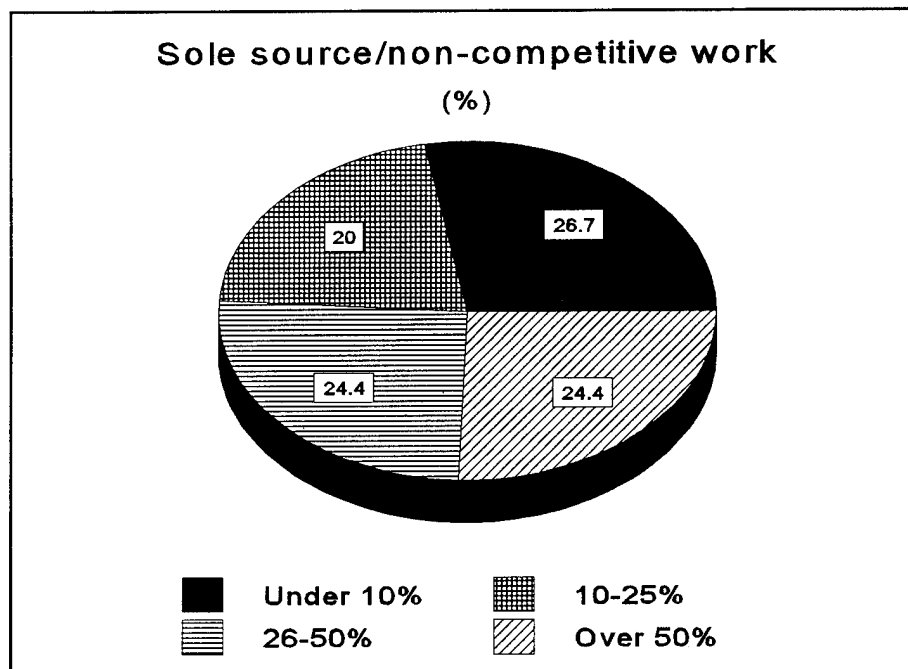


Figure 4. Responses to Question #5

Question #6:

What is your primary product or service?

Respondents represented a wide and diverse range of defense products and services; a complete listing of responses is provided in Appendix B.

C. SURVEY QUESTIONS

Questions 7-11 were intended to elicit responses regarding general familiarity and use of the Weighted Guidelines within the defense industry, supplemented by respondent comments.

Question #7:

Are you familiar with DoD's Weighted Guidelines and the use of DD Form 1547?

Of the 45 correctly completed surveys, 38 were familiar with the Weighted Guidelines, as shown in Figure 5. Only these 38 were asked to complete the remainder of the questionnaire; the percentages for all further questions are based on these 38 responses. The 38 respondents familiar with the Weighted Guidelines can further be divided by prime and subcontractor: 29 of 38, or 76.3%, were prime contractors, while the remaining nine, or 23.7%, were subcontractors. These figures mirror the distribution of total respondents, as discussed in question 1.

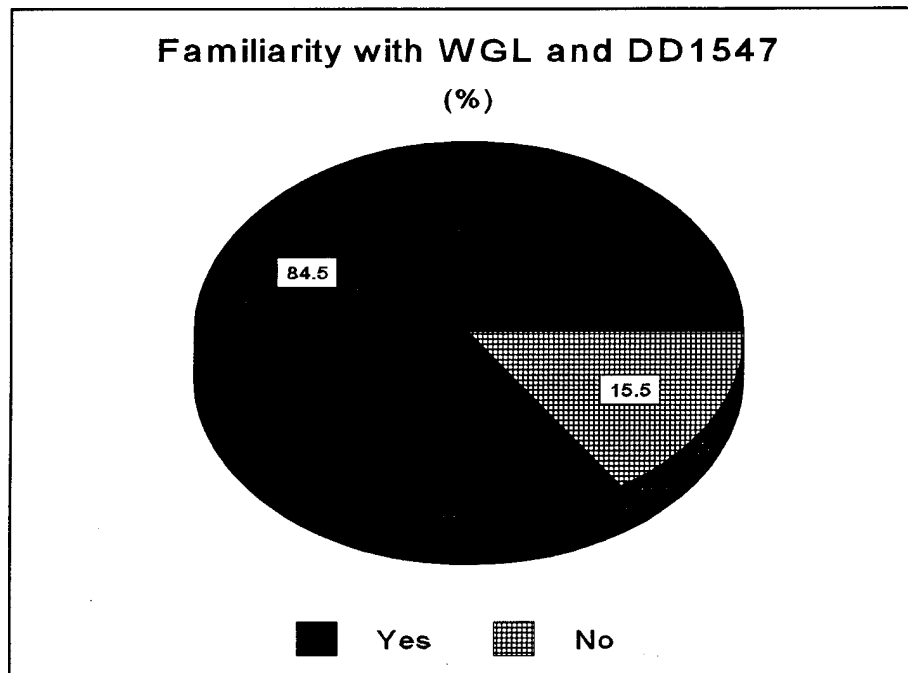


Figure 5. Responses to Question #7

Question #8:

Does your firm use the Weighted Guidelines, including DD Form 1547, to prepare for negotiations with the Government? If yes, how does your use of the Weighted Guidelines affect the negotiation process? If not, why not? How does your firm establish profit objective?

As shown in Figure 6, the majority of respondents do not use the WGL to prepare for negotiations with the Government.

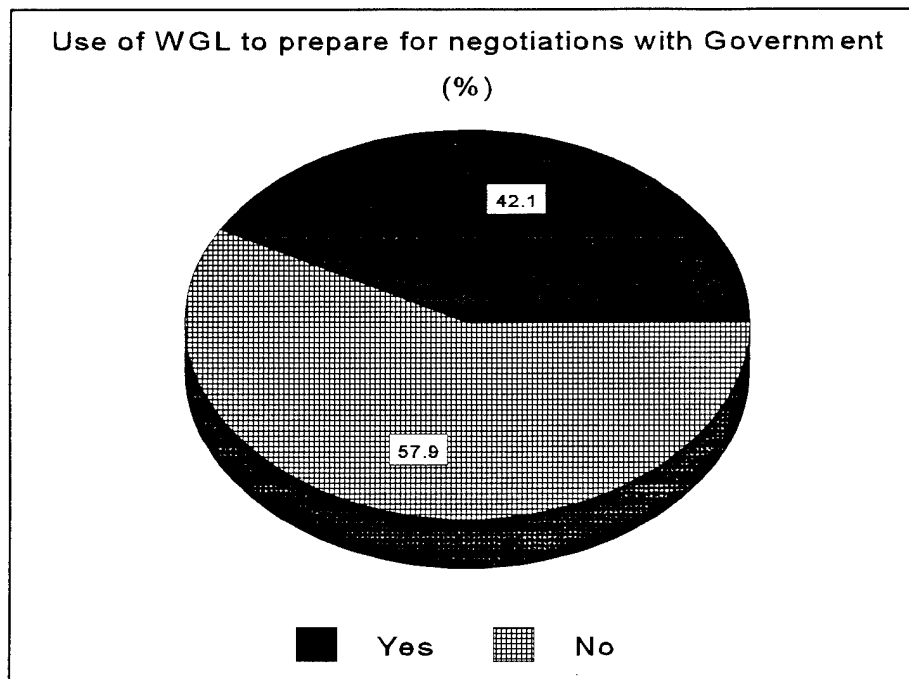


Figure 6. Responses to Question #8

Those respondents who use the WGL to prepare for negotiations with the Government indicated a desire to establish a common frame of reference for discussions with the contracting officer. These firms felt that the WGL allow them to understand the Government position. Those firms who do not use the WGL generally use other means, such as shareholder expectations or corporate goals, to establish profit objective.

Respondents who use the WGL made the following comments:

- As a guide only - this helps us understand the Government's position although we might not agree.
- Helps understand the customer's position.
- Enables a common-base discussion of factors affecting profit/fee.
- We use the approach to establish our basis for discussing our proposed profit objectives.
- It's only used if the Government negotiator makes reference to it.
- We use it to establish a profit objective. It allows the parties to reach a fair and reasonable price providing both parties can agree on the factors.
- Only as a check to determine where the Government will be coming from.
- Only to independently assess the Government's use of the method.
- We use it for (1) a check on the relationship to what we propose, and (2) development of arguments to support the profit position during negotiations.
- To substantiate profit objectives.
- WGL does not have a large impact because it is subjective; the customer's calculations tend to be lower than the contractor's.
- I will push to get a profit in line with WGL and build a case for using higher than average factors.
- Delays the negotiation process because of the subjectiveness.

Respondents who do not use the WGL made the following comments:

- Subjective risk assessment.
- They are too subjective.
- Negotiate.
- Standard bid is 10-20% depending on type of contract.
- Profit is established on basis of solicitation, competitive bid or sole source, per product, lot quantity to manufacture.
- The WGL have little basis in "business" reality. Our firm's profit objectives are a function of corporate profit goals. Most WGL calculations fall below these goals.
- The WGL method does not properly reflect the fundamental rule associating risk and return to the contractor.
- Profit objectives cannot be established by a form. They are set by management to meet shareholder return objectives.
- We use the actual manufacturing costs from our standard commercial cost systems and apply a fixed percentage gross margin.
- We establish objectives based on a return on capital employed as determined by our shareholders. The WGL can be manipulated based on subjective evaluation of risk by the evaluator.
- Our profit objective is based on risk and investment.
- Management direction based on competition and historical experience for similar contracts.

- We use a standard commercial pricing approach.
- Management discretion based on cost of capital, unallowables, and required rates of return.
- We propose and negotiate with profit objectives expressed as a percentage of most probable cost.
- Based on commercial profits. Weighted Guidelines are too limiting/myopic.
- The Government shares their calculations. No advantage in having our own.

Question #9:

Does your firm use the Weighted Guidelines, including DD Form 1547, to prepare for negotiations with other contractors?
If not, why not?

The vast majority of respondents do not use the WGL to prepare for negotiations with other contractors, as shown in Figure 7. In general, these firms felt that the WGL are not relevant for commercial negotiations, since the WGL are not widely used within industry. Additionally, respondents cited a desire to avoid the paperwork burden associated with performing a WGL analysis, as well as a perceived lack of advantage to use of the WGL.

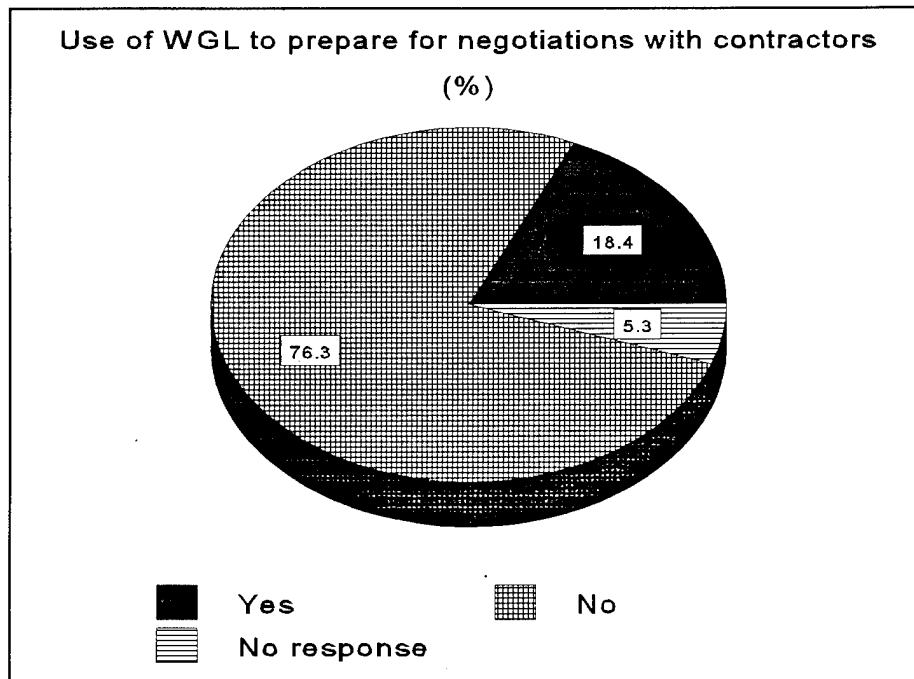


Figure 7. Responses to Question #9

Comments by respondents included the following:

- Normally other contractors do not use WGL. We use WGL when the prime is familiar with it and they use it.
- Not relevant.
- Paperwork burden not necessary; negotiators authorized to settle based on their judgment.
- 95% of awards are based on competition. We adjust profit to a level where we believe we can win an award.
- We examine the level of risk and also the investment of company resources/talent in order to determine the amount of fee/profit which needs to be earned on a particular job.

- Serves no purpose.
- Non-negotiable.
- Other contractors do not use WGL.
- Do not perceive an advantage.
- Most of our contractors could care less about the Weighted Guidelines. The percentages seem arbitrary.
- Not meaningful or widely used in our industry.
- Automotive industry is not receptive nor accustomed to WGL.

Question #10:

Do you believe the Weighted Guidelines approach favors any particular set of contractors? If yes, please explain.

The responses to question 10 provided no real consensus. There was a relatively even distribution with a significant number, 26.3%, of non-responses. Overall, those respondents who did not believe the WGL favored any particular set of contractors outweighed those who did by a slight margin. Among respondents indicating a belief in WGL "bias", virtually all felt that the WGL favor large prime contractors with significant investment in facilities and equipment, and highly skilled technical personnel. Figure 8 represents responses to question 10.

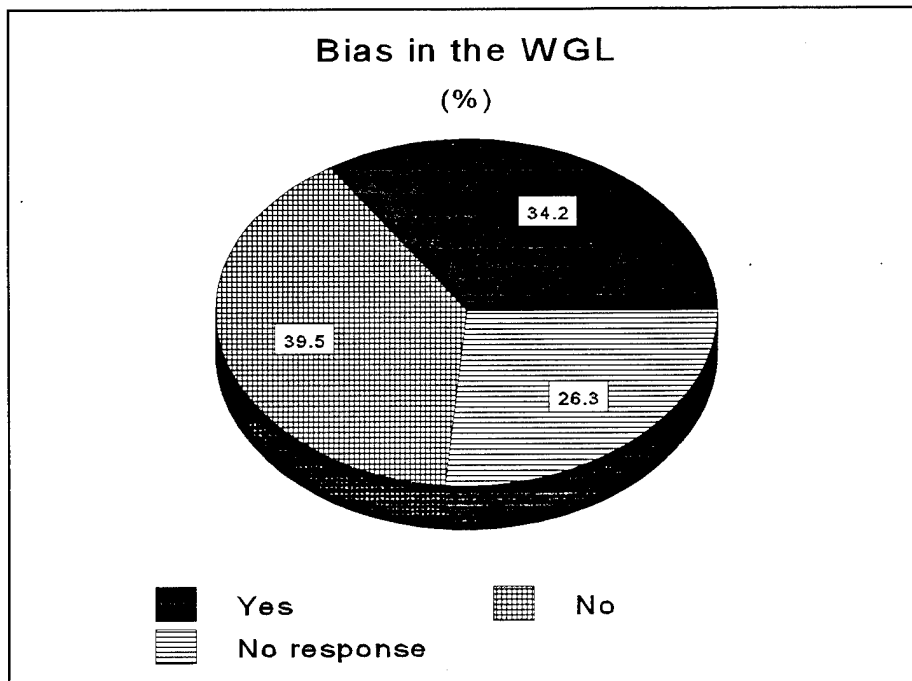


Figure 8. Responses to Question #10

Comments by respondents included the following:

- Favors slightly those contractors who own their own facilities and possess highly skilled technical personnel.
- Manufacturers are favored by the weights assigned which do not consider the investment in facilities sometimes required to perform service contracts.
- Major prime contractors with sole source contracts.
- Very large primes with significant investment in buildings, facilities and equipment.
- Well established large contractors have resources to justify higher fees pursuant to the WGL criteria. Smaller companies don't.

- Large firms with highly structured overhead pools, large capital investments and complex cost structures.
- Those with large investments in buildings and equipment should be able to achieve a higher profit to compensate them for their capital investments. WGL support higher profit objectives that do have higher investments.
- It favors contractors who are primarily defense contractors. You can game the form by making most costs overhead vs. G & A. Commercial contractors have no incentive to do this.
- Via the Government person who is applying the approach.

Question #11:

Do you believe the Weighted Guidelines approach is more effective when used to negotiate: (A) Fixed-price contracts; (B) Cost-reimbursement contracts; or (C) Equally effective in both cases.

A significant number of respondents, 42.1%, failed to answer this question. A small number felt the WGL are most effective when negotiating fixed-price contracts, while approximately twice as many felt the approach is most effective for cost-reimbursement negotiations. An identical number felt the WGL are equally effective under either contract type. Figure 9 represents responses to question 11.

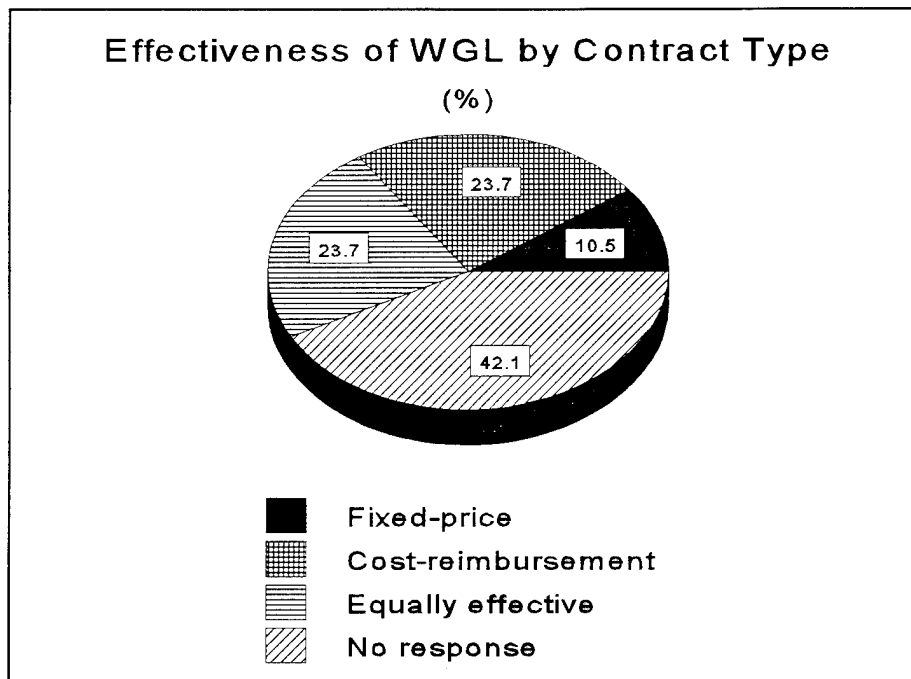


Figure 9. Responses to Question #11

Respondents were asked to answer questions 12 through 24 by selecting from the choices of Agree, Neutral or Disagree. 5 respondents, 13.2%, failed to complete this portion of the questionnaire. These questions were designed to elicit opinions on specific aspects of the Weighted Guidelines, as well as a general overview of the effectiveness of the policy.

Question #12:

DoD contracting officers have a good understanding of how to interpret and apply the Weighted Guidelines.

Only a small percentage, 28.9%, agreed with this statement. Figure 10 represents responses to question 12.

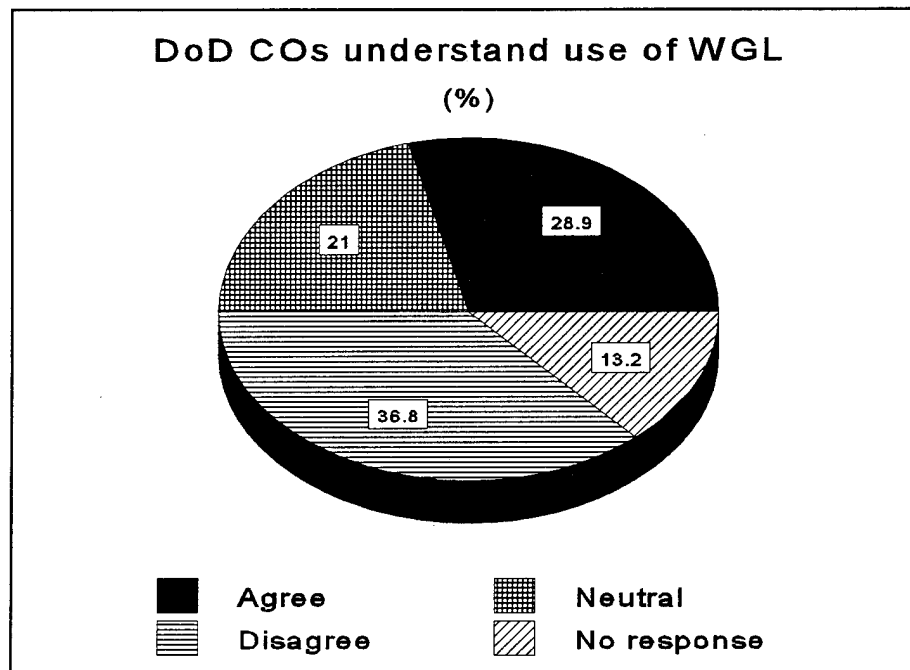


Figure 10. Responses to Question #12

Question #13:

Contractor capital investment is fairly rewarded under the Weighted Guidelines approach.

Only 15.8% agreed with this statement; 44.7% disagreed. Figure 11 represents responses to question 13.

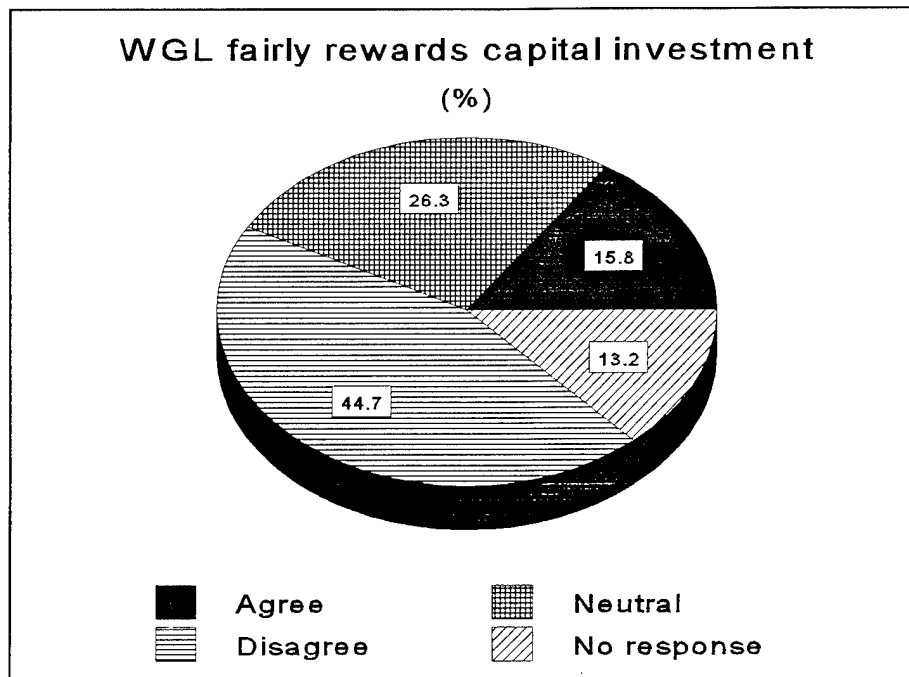


Figure 11. Responses to Question #13

Question #14:

The current Weighted Guidelines approach is sufficiently flexible to provide adequate profits to the majority of contractors.

The majority of respondents, 55.3%, disagreed with this statement. Only 15.8% agreed, with an equal number neutral. Figure 12 represents responses to question 14.

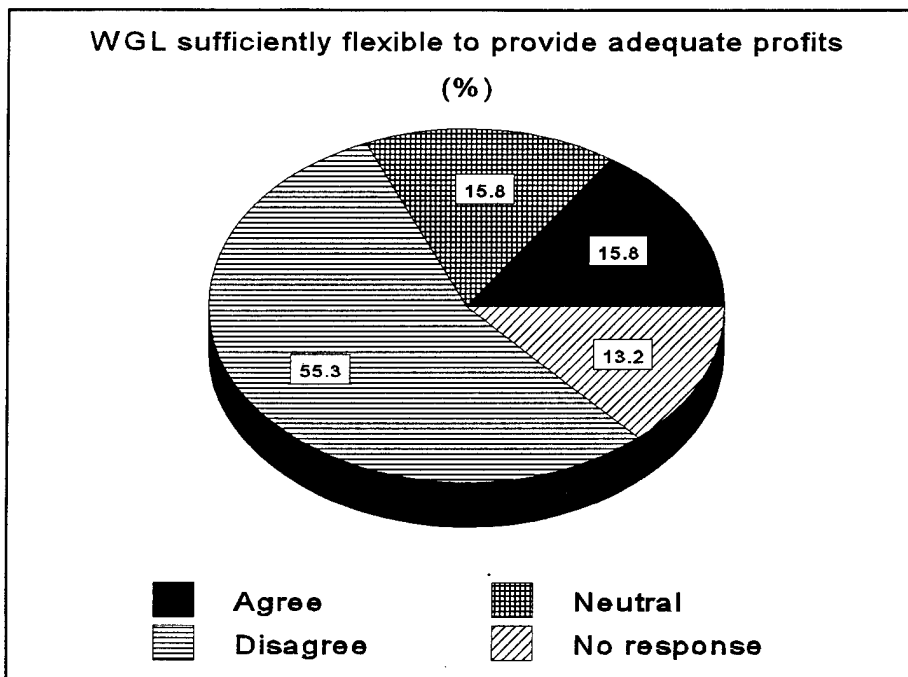


Figure 12. Responses to Question #14

Question #15:

Negotiated contractor profits would be higher if DoD did not use the Weighted Guidelines.

A significant number of respondents, 36.8%, were neutral to this statement, representing the most prevalent response. Slightly more than one-third, 34.2%, agreed with this statement. Only 15.8% disagreed. Figure 13 represents responses to question 15.

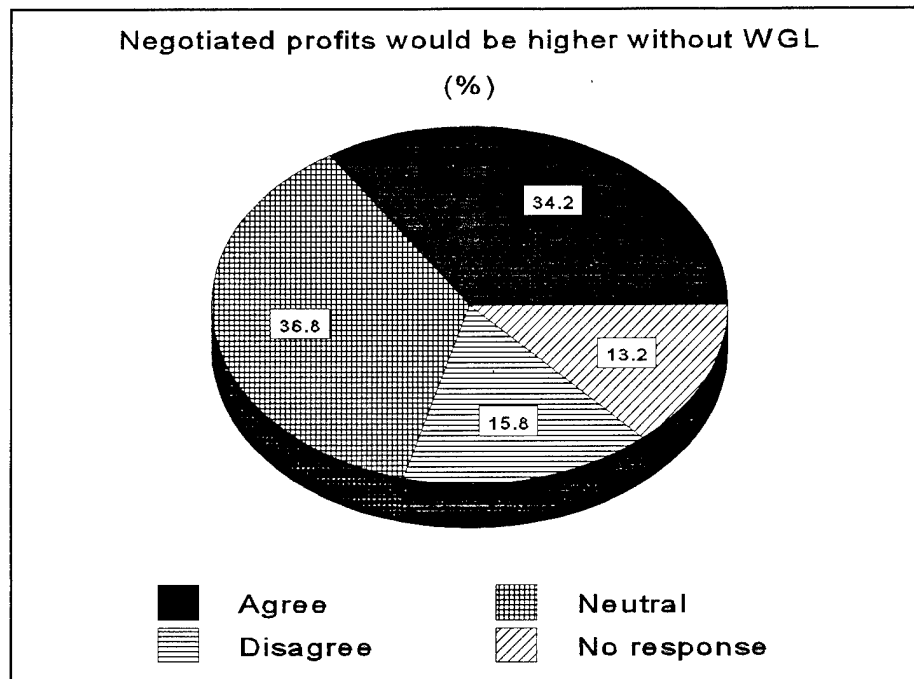


Figure 13. Responses to Question #15

Question #16:

The range of values available for assignment by DoD contracting officers provides adequate recognition of a contractor's performance risk.

A large number of respondents, 57.9%, disagreed with this statement. Only 7.9% of the respondents agreed, while nearly three times as many, 21%, were neutral. Figure 14 represents responses to question 16.

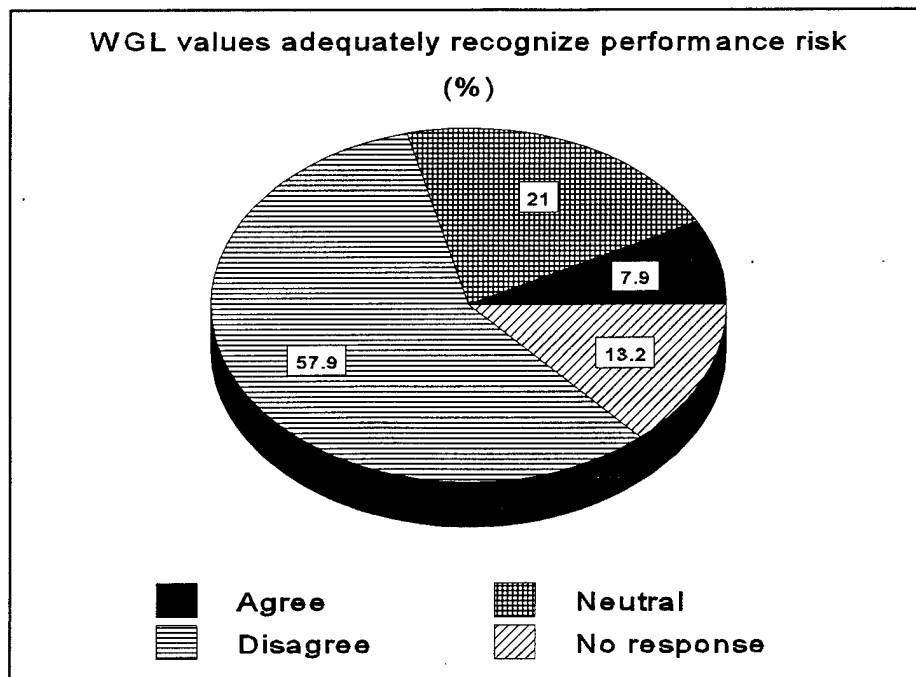


Figure 14. Responses to Question #16

Question #17:

I frequently have significant differences with the contracting officer's use of the Weighted Guidelines and DD Form 1547.

A large majority of respondents, 57.9%, agreed with this statement. A small number of the respondents, 7.9%, disagreed while nearly three times as many, or 21%, were neutral. Figure 15 represents responses to question 17.

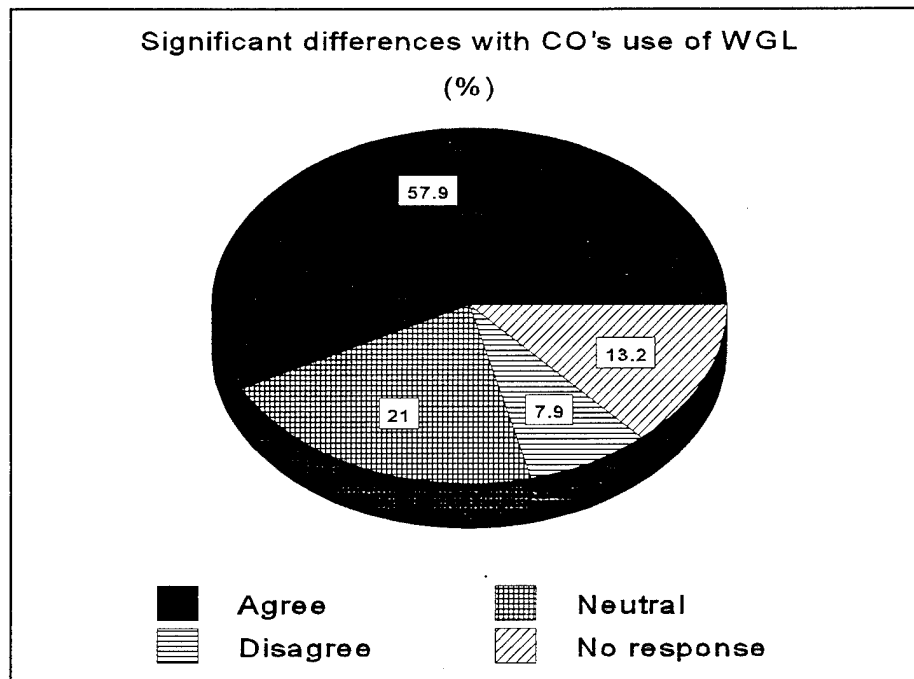


Figure 15. Responses to Question #17

Question #18:

The use and application of the DD Form 1547 is clear and understandable.

Only 15.8% of the respondents agreed with this statement. Exactly twice as many, 31.6%, were neutral. An even larger number of respondents, 36.8%, disagreed. Figure 16 represents responses to question 18.

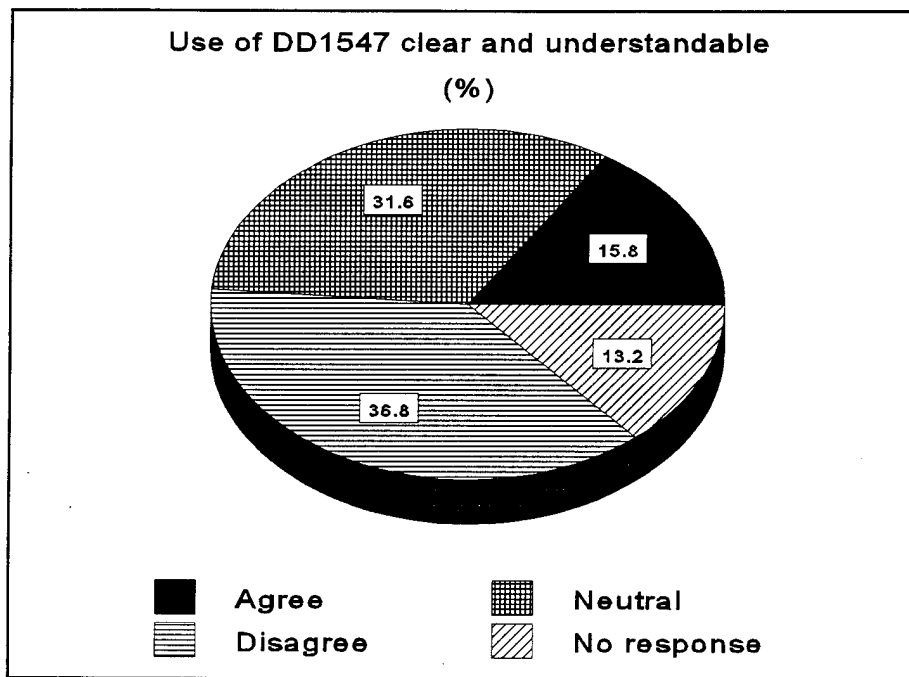


Figure 16. Responses to Question 18

Question #19:

The range of values available for assignment by the contracting officer provides adequate recognition of the risk to the contractor associated with various contract types.

Very few of the respondents, only 10.5%, agreed with this statement. Over four times as many, 44.7%, disagreed. Additionally, a significant number, 31.6%, were neutral. Figure 17 represents responses to question 19.

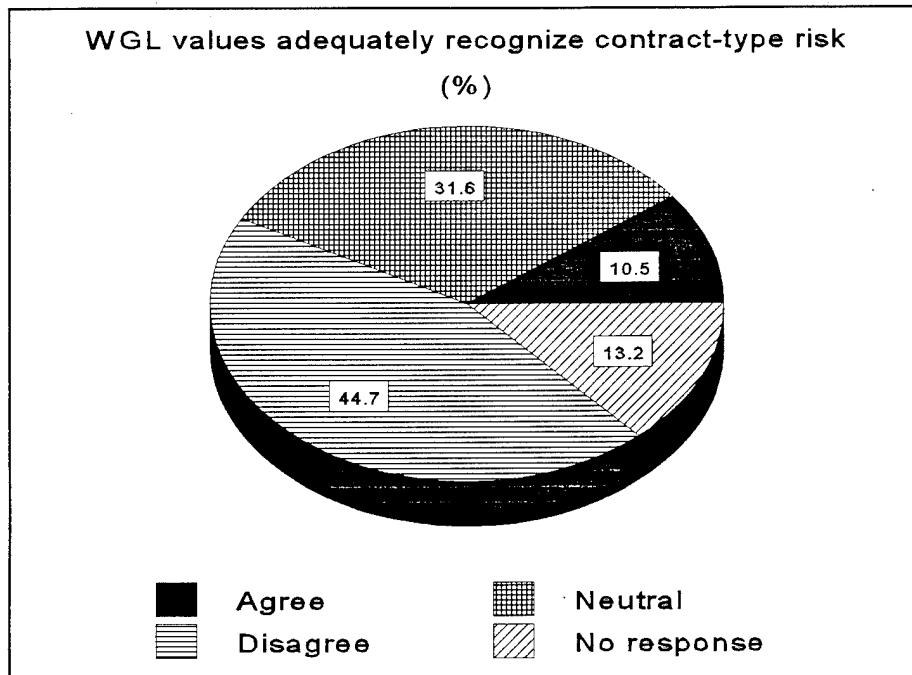


Figure 17. Responses to Question #19

Question #20:

The Weighted Guidelines factors for facilities capital employed are sufficient to encourage capital investment.

A large majority of respondents, 65.8%, disagreed with this statement. Only one of the thirty-eight respondents, or 2.6%, agreed. In addition, 18.4% of respondents were neutral. Figure 18 represents responses to question 20.

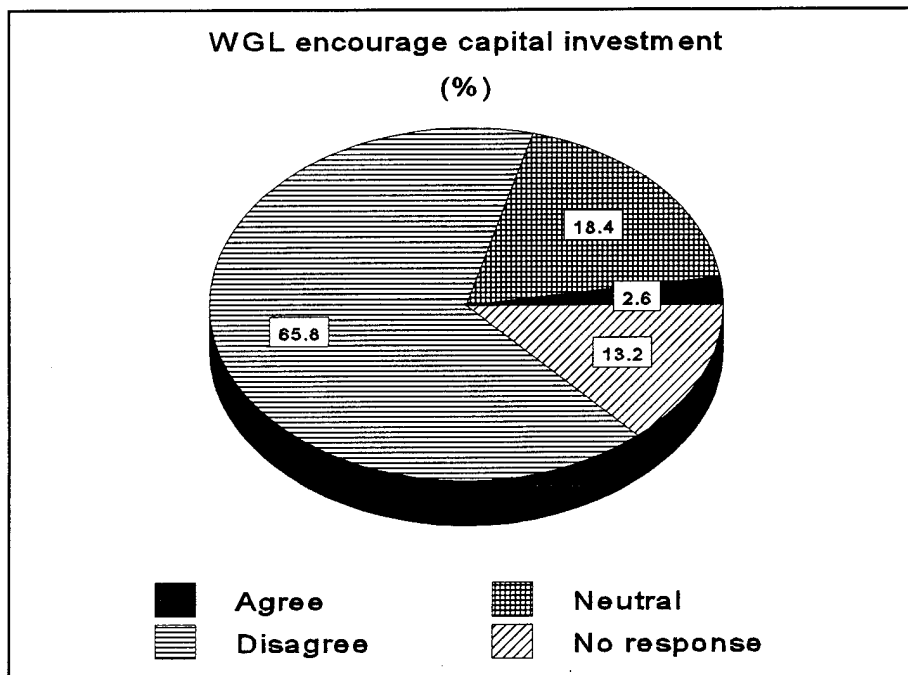


Figure 18. Responses to Question #20

Question #21:

The Weighted Guidelines, as a vehicle for implementation of DoD's profit policy, provide sufficient incentive for contractors to remain active members of the defense industrial base.

The vast majority of respondents, 78.9%, disagreed with this statement. None of the respondents agreed; 7.9% were neutral. Figure 19 represents responses to question 21.

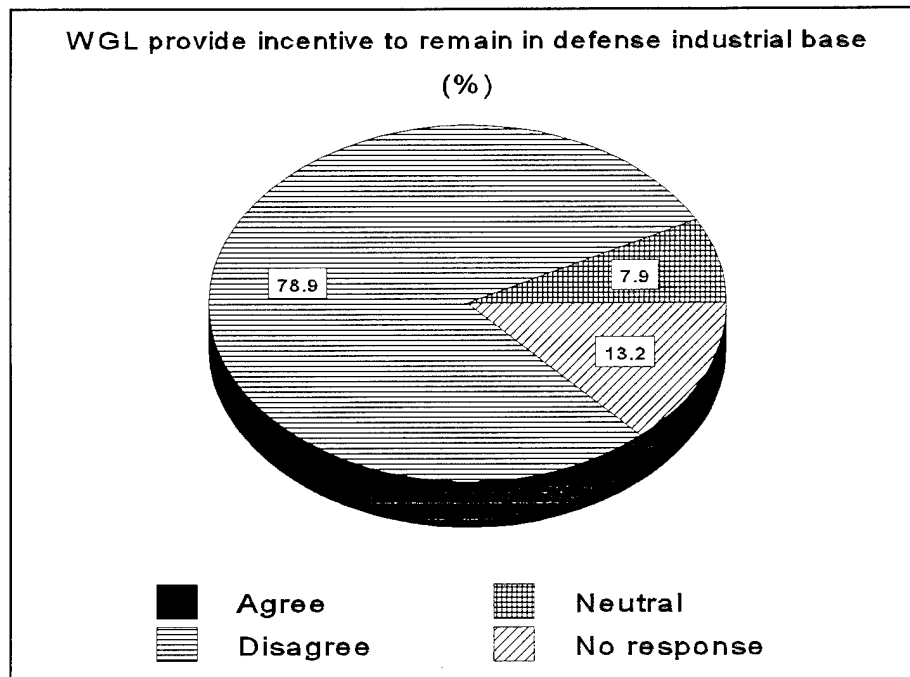


Figure 19. Responses to Question #21

Question #22:

The Weighted Guidelines are used more as a crutch to justify the final negotiated price than as a tool to develop an appropriate profit objective.

A large majority of the respondents, 65.8%, agreed with this statement. Only 7.9% of the respondents disagreed with the statement, while 13.2% were neutral. Figure 20 represents responses to question 22.

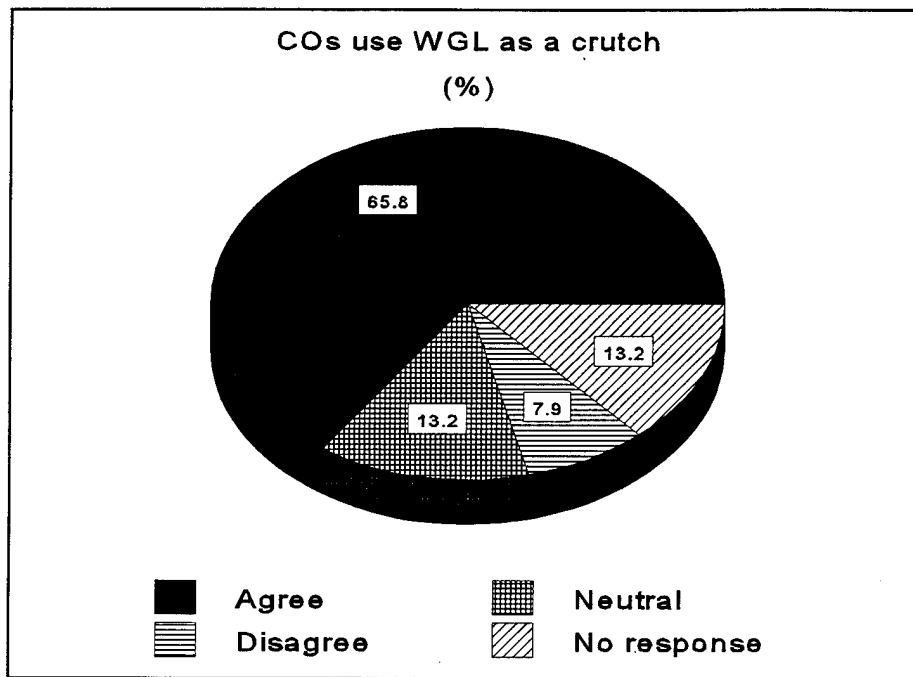


Figure 20. Responses to Question #22

Question #23:

Regardless of the Weighted Guidelines, specific contractors are out for a specific return on each contract.

The vast majority of the respondents, 71%, agreed with this statement. Only 5.3% disagreed with the statement, while 10.5% were neutral. Figure 21 represents responses to question 23.

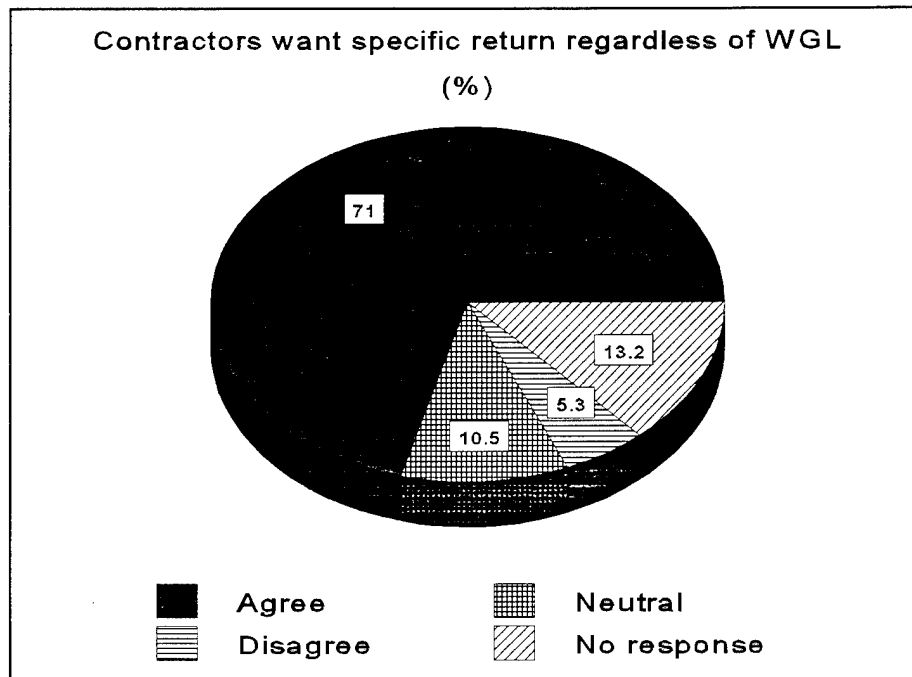


Figure 21. Responses to Question #23

Question #24:

The Weighted Guidelines is a fair and effective means of establishing profit objective.

Question 24 was designed to serve as a summary of questions 12 through 23. The negative opinions of the WGL expressed through the previous questions were reflected by the 63.2% of respondents who disagreed with this statement. Only 2.6% agreed; 21% were neutral. Figure 22 represents responses to question 24.

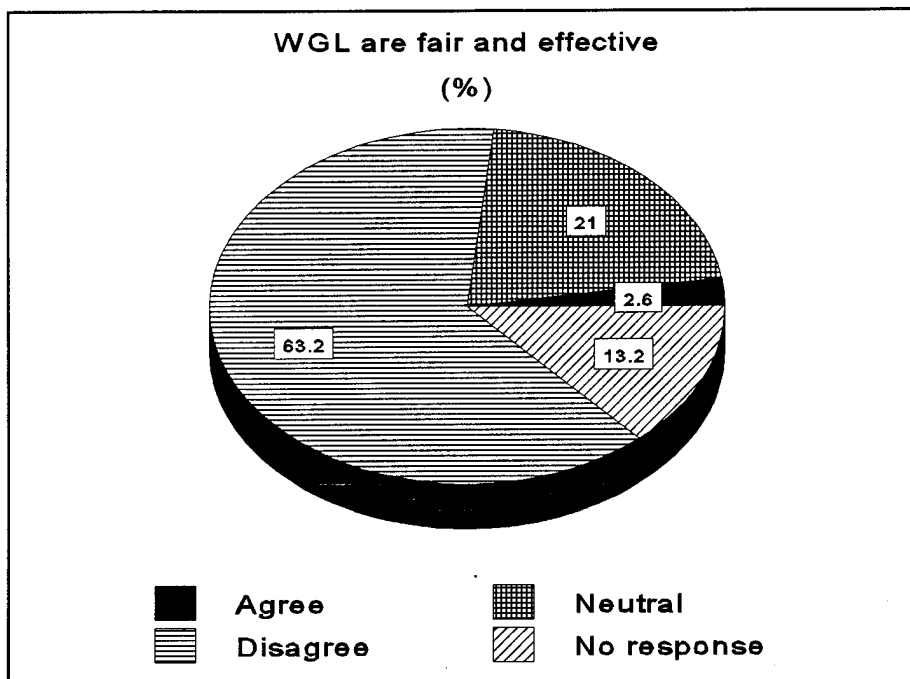


Figure 22. Responses to Question #24

Questions 25 and 26 were designed to elicit opinions on the future of the Weighted Guidelines and industry recommendations for improvement.

Question #25:

Do you feel the Weighted Guidelines approach should be:
(A) Retained as is; (B) Modified; (C) Replaced; or (D)
Eliminated.

Dissatisfaction with the WGL was reflected by the majority of respondents, 55.3%, who recommended elimination of

the approach. No respondents recommended retaining the system in its present form. Figure 23 represents responses to question 25.

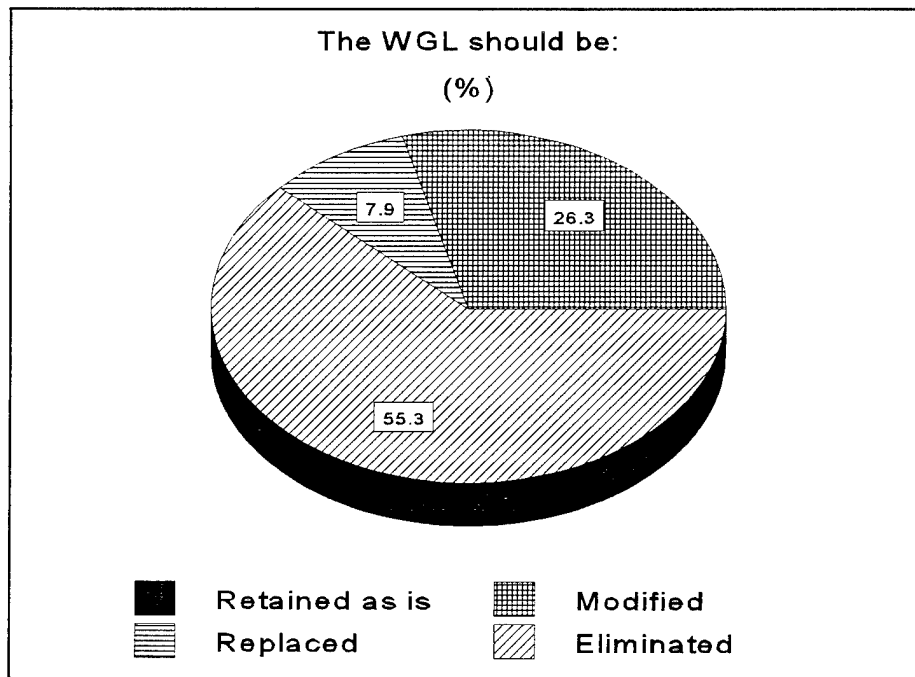


Figure 23. Responses to Question #25

Question #26:

What changes, if any, would you make to improve the Weighted Guidelines?

The majority of responses focused on two areas: total elimination of the Weighted Guidelines, and a desire for increased emphasis on risk. In general, many respondents felt

the contracting officer should be allowed to use "business judgment" to determine profit rate during negotiations. Others recommended making the WGL more "user-friendly", and improved training for Government personnel.

Comments by respondents included the following:

- Eliminate the subjectivity of the form.
- Emphasize that these are guidelines - not factors written in stone. The CO needs some basis other than a number from thin air but WGL is just that, and it is based on a very subjective evaluation of each factor.
- The range of values available for assignment should be more clearly defined; too much is left to interpretation.
- Eliminate.
- Eliminate it and leave it up to the contractor to negotiate.
- Do away with them.
- Eliminate them and allow each CO to negotiate in a real free market environment.
- Eliminate it.
- Throw them out and start anew!
- Eliminate - encourage a structural approach in determining profit/fee that is an acceptable return on investment.
- Recognize that any contract contains risk and that there should be a realistic expectation on all parties' part that a contractor must make a reasonable profit. I would recommend less concern about profit and more focus on the elements of cost of a contract.

- Consideration should be given to what constitutes an acceptable return, but no Government official wants to be questioned by Congress if the profit is perceived to be too high. The WGL allow the CO to say, "I followed the form, there must be a problem with the rules, not me".
- The risk section should be the most significant driving factor in determining profit. To do so adequately would require the promulgation of a very large form to include contractor concerns.
- Greater recognition of risk.
- More emphasis on risk.
- More specific statement of desired results and basis for payment for results. Risk factors are too general to be meaningful.
- Simplify the completion of the form.
- Make it more user-friendly; less bureaucratic.
- Indoctrinate Government representatives to use WGL to justify profit in lieu of using it to reduce profit.
- Provide better training to Government buyers using them.
- Provide more guidance; provide more definitions and examples; give the buyer more flexibility; preclude commands from requiring absolute adherence; get realistic in the amount of margin provided for.
- Think logically; you can't legislate profit objectives.
- There is nothing wrong with WGL if equity is applied, which is not always the case.
- None - they seem to accomplish what they are intended to do.

Question 27 was designed to allow respondents to present a final, overall characterization of the Weighted Guidelines.

Question #27:

How would you characterize DoD's profit policy, including the Weighted Guidelines and the DD Form 1547?

Again, the majority of comments were negative. Specific comments by respondents included the following:

- The basic policy is sound. The WGL might be better expressed as a range, not an absolute.
- It is a good basis to use as long as PCOs do not predetermine maximum profit rate.
- In general, unrealistic. If a company can't make at least 10-15% profit on routine orders, it will not be able to stay in business.
- Regardless of the profit resulting from WGL, from my experience profit rates of 10-15% are negotiated on firm fixed-price contracts and 7-10% on cost-type contracts.
- The Government does not use WGL in negotiating unless it is to their advantage. Often WGL will calculate a 10-12% profit and the Government expects us to accept historical percentages which are much lower (8-9%).
- A necessary evil. In today's competitive environment, the policy is only marginally relevant.
- Cheap.
- Out of date.

- Confused.
- Moderately confusing.
- Standardized bureaucracy.
- Highly interpretive, subjective.
- Inconsistent and varying; depends on specific agency and level of CO.
- The guidelines are arbitrary. A wide range of values can be established by the CO based upon his/her subjective evaluation. Therefore, they lend a false sense of precision to an arbitrary process.
- DD Form 1547 was designed by the DoD, for the DoD, to benefit the DoD. If a WGL approach is mandatory, DoD and private industry should work together to modify the format to allow wider flexibility.
- In the commercial world, profits depend on the marketplace - the better you provide a product the better the return; no such incentive with the Government.
- DoD seems to feel that profit is a dirty word. The entire thrust of the WGL approach appears to be to provide the CO with a means to support his actions and to ensure that no one makes very much more than the next guy.
- Great for MBAs. Contractors will do whatever they must to win. We need to have an understanding between Government and industry on where we want to go. We can work together.
- A policy, as such, is appropriate, but the Government is completely unrealistic in terms of returns required by the investing public.
- Minimizes contractor profit to the maximum extent possible.

- It's the absolute Big Brother syndrome - the Government is telling the contractor what his risk is worth.
- I view the WGL as a tool that allows both parties some guidance in arriving at a fair and reasonable price. Obviously there is a great deal of subjectivity in the application of the factors.

Respondents were then asked to provide any additional comments, as desired. These comments include the following:

- Guidelines tend to become fixed points, like legal opinions and audit reports. They are all supposed to be advisory with the responsibility for a decision left to the CO, but pity the poor CO who decides contrary to one of his "advisors" without pages of justification.
- My company routinely delivers a quality product on time. These facts are virtually ignored by those persons using the WGL. If you are really interested in retaining good suppliers, change the system to reward those that perform.
- DoD needs to incentivize the industrial base to do defense work, not avoid it due to unacceptable return.
- If a company has experienced production problems in the past, i.e. required materials are difficult to obtain, high scrap rates, labor intense, many complicated manufacturing processes, etc., then expect proposed profit to be high due to the inherent risks involved. Another factor is history; did the company make or lose money on previous orders? These are the true guidelines used by most companies to determine profit objectives, guidelines which are not addressed in the WGL work sheet. Government contracting employees rarely understand the above because so few have worked in private industry.

- Many negotiations go to a bottom line settlement where the parties never agree on or negotiate profit as a separate item under fixed-price contracts.
- We need to understand in a capitalistic society it is OK to make money, even at the taxpayer's expense. If the buyer is getting what is wanted, the taxpayer benefits. We are all taxpayers, so no one wants the Government to be overcharged, but at the same time contractors have to make a return on investment.
- As Government personnel become more familiar with the profit expected for that kind of commodity/service, that is fair and reasonable to both sides, they will rely less on the WGL form and more on good business judgment.
- COs, in my experience, do not have a good understanding of profit. Many seem to feel it is their moral obligation to all but eliminate profit. The WGL are only as good as people using it are trained to use it. If COs and negotiators understood the importance of profit to industry, I believe this alone would be a significant improvement.
- The Government should have policies and guidelines for procurement activities to follow. But they must learn to procure from commercial businesses using commercial practices. The market will reward the best products/services and the best managed businesses.
- The Weighted Guidelines are, in my opinion, misused. PCOs tend to use them to lock into unrealistically low profit objectives, then use them as a "lever" to justify not moving in profit during negotiations.
- I think the WGL are a vehicle for posturing in negotiations. The WGL are a vehicle for communication of positions and is suitable for that purpose.

- While working at DCASMA San Diego, I learned that most contract administrators really did not know how to properly use Weighted Guidelines; numerous errors were common.
- The Government does not use the WGL in negotiating unless it is to their advantage. Often WGL will calculate a 10-12% profit and the Government expects us to accept historical percentages which are much lower (8-9%).
- Subjective judgment of performance will generally serve only Government profit objectives.
- Profit is important, but smaller contractors believe that what they are doing is important, maybe more so than a profit projection. Some of us would continue doing business with DoD if we could get a modest 0-5% profit. It can be rewarding if we can make a difference. Money isn't everything!

D. SUMMARY

This chapter has presented the data received from respondents' questionnaires. The major points can be summarized as follows:

- The vast majority of respondents were familiar with the WGL, but less than half use the approach to prepare for negotiations with the Government; even fewer use the WGL to prepare for negotiations with other firms.
- The majority feel the WGL are not flexible enough to provide adequate profits.
- The WGL do not adequately recognize performance risk or contract-type risk, nor does the method incentivize capital investment.

- The WGL do not incentivize contractors to remain active members of the defense industrial base.
- The majority of contractors desire a specific return regardless of WGL.
- The majority of respondents feel the WGL approach is not a fair and effective means of establishing profit objective.
- All the respondents feel the WGL should be modified, replaced, or eliminated.

The following chapter will analyze and discuss the data in detail.

V. ANALYSIS

A. INTRODUCTION

The purpose of this chapter is to provide an analysis of the results described in Chapter IV, as well as general observations made by the researcher in the course of the study. Where appropriate, contractor comments listed in Chapter IV will be repeated to clarify points of discussion.

B. OVERALL VIEW OF THE WEIGHTED GUIDELINES

Several of the questions asked as part of this research were designed to elicit overall, "big picture" opinions of the Weighted Guidelines (WGL). The results of these questions can be summarized as follows:

- Only 15.8% of respondents agreed that the current Weighted Guidelines are sufficiently flexible to provide adequate profits to the majority of contractors.
- Only 15.8% disagreed that contractor profits would be higher if DoD did not use the Weighted Guidelines.
- Only 15.8% believed that the use and application of the DD Form 1547 is clear and understandable.
- A majority of 65.8% believed that Weighted Guidelines are used more as a crutch to justify final negotiated price than as a tool to develop an appropriate profit objective.

- Only one respondent, or 2.6%, agreed that the Weighted Guidelines approach is a fair and effective means of establishing profit objective.
- The vast majority, 89.5%, of respondents believed that the Weighted Guidelines should be modified, replaced or eliminated; none agreed that the Weighted Guidelines should be retained as is.

These results present a very negative picture of the WGL, from the perspective of the defense industry. This is not altogether surprising; Government and industry tend to regard each other as adversaries.

Respondents were also asked to characterize DoD's profit policy, including the Weighted Guidelines and DD Form 1547. Comments in response to this question were overwhelmingly negative. Representative comments include:

- Cheap
- Out of date
- Confused
- Obsolete
- A necessary evil; in today's competitive environment the policy is only marginally relevant.

In general, respondents feel that profit policy, and WGL in particular, does not properly reward risk and investment, fails to incentivize firms to remain in the defense marketplace, and fails to reward firms for providing quality

products or services. These views will be analyzed and discussed in detail below.

C. RISK AND RETURN

The Weighted Guidelines are designed to allow the contracting officer (CO) to address contractor risk during the process of determining prenegotiation profit objectives. Values assigned to Performance Risk and Contract-type Risk should reflect the degree of risk assumed by the contractor under the instant contract.

Results of the research indicate that a large number of defense contractors feel that DoD does not properly recognize risk as a profit determinant. The following comments highlight this point:

- It's the absolute Big Brother syndrome; the Government is telling the contractor what his risk is worth.
- The risk section should be the most significant driving factor in determining profit.
- "Risk factors" are too general to be meaningful.
- [The Weighted Guidelines need] greater recognition of risk.
- More emphasis on risk.

The view that the WGL fail to adequately recognize risk is substantiated by other survey results:

- Only 7.9% of respondents agreed that the range of values available for assignment by DoD COs under the WGL adequately recognizes performance risk.
- Only 10.5% of respondents agreed that the range of values available for assignment by DoD COs under the WGL adequately recognizes contract-type risk.

The research indicates that prime contractors appear to be more concerned with risk than subcontractors. Seventy-five percent of the responding prime contractors felt the WGL do not adequately recognize performance risk, while just 44.4% of subcontractors cited this belief. Similarly, 58.3% of prime contractors and 33.3% of subcontractors felt the WGL do not adequately recognize contract-type risk. In both instances the majority of subcontractors, 55.3%, were neutral.

Concern with this issue can be assessed by the number of references to risk made by the respondents in their narrative responses. Most of the comments were of a brief nature, with little or no substantiation or examples. Only 28.9% made comments on risk or risk-related subjects. Of the prime contractors, 27.6% commented on risk; 33.3% of the subcontractors made similar comments.

The small number of comments made regarding risk does not reflect the dissatisfaction with the WGL apparent from the overall percentages described above. This may indicate that WGL recognition of risk, while a concern, is not as important as other issues. It is possible that the respondents believed no comment was necessary due to the responses provided for other questions. It is also interesting to note that, while only 10.5% of respondents felt that the WGL adequately recognize contract-type risk, no narrative comments were made on this issue. Contract-type risk may be a low priority.

Clearly, if contractors felt their risk was not being adequately recognized by the Government, they would cease to perform Government work. In line with the economic theory of profit, some investments (or in this case DoD contracts) will make a profit, while others will not. If failure to make a profit was a frequent occurrence, there would be few if any firms left in the defense marketplace. Since there are still many firms willing to perform DoD work, adequate profit must be available. But, as the economic theory of profit also states, those who take larger risks expect a larger reward. It is likely, in the researcher's opinion, that defense contractors feel that DoD business, while profitable, is not as profitable as it should be considering the risks involved.

Related to risk is the matter of return on investment. Many of the respondents indicated a belief that DoD does not understand nor provide the defense industry with a reasonable return on investment. Comments include:

- ...there should be a realistic expectation on all parties' part that a contractor must make a reasonable profit.
- Consideration should be given to what constitutes an acceptable return.
- ...unrealistic. If a company can't make at least 10-15% profit...it will not be able to stay in business.
- ...the Government is completely unrealistic in terms of returns required by the investing public.

This view appears to run counter to the Government's stated goal of incentivizing efficient contract performance by "offering sufficient financial rewards". [Ref 6:p.15-37] However, a great deal depends on one's definition of "sufficient financial rewards". For example, one of the respondents indicated a need to make at least 10-15% profit to stay in business. In this firm's view, 10-15% is "sufficient reward". Unfortunately, this type of figure cannot be generalized. Contracts with a large degree of risk and uncertainty deserve a larger profit than contracts with low risk factors. At the same time, many other factors must be

considered. Is the firm as efficient as possible? What has the firm done to mitigate its costs? Obviously, no firm is 100% efficient, but as efficiency increases and unnecessary costs decrease, the amount of profit required to "stay in business" will decrease. Additionally, as several respondents noted, companies must deal with corporate goals, shareholder expectations, and other forces which may take little or no regard to business mix or the risk involved with contracts assumed.

D. CAPITAL INVESTMENT

The WGL are also designed to promote capital investment by contractors. However, only 15.8% of the respondents indicated a belief that the current WGL approach fairly rewards capital investment. Additionally, only 2.6% of respondents agreed that the WGL factors for facilities capital employed are sufficient to encourage capital investment; 65.8% disagreed. These results mirror a 1989 study regarding the effect of DoD profit policy on capital investment. In that study, 75% of the defense contractors interviewed indicated that DoD's profit policy provided inadequate or no incentive to invest in more productive facilities and equipment. [Ref 4:p.73] No comments were made by the respondents regarding

capital investment issues due to, in the researcher's estimation, a perceived lack of relevance of the WGL approach. It would seem, despite initiatives to encourage investment such as those resulting from the Profit '76 Study, that the defense industry still does not feel that DoD profit policy and the WGL provide proper incentive to invest.

It is unrealistic to believe that capital investment within the defense industry is going to increase in today's economic environment. The availability of future defense business is too uncertain. The majority of firms will not be willing to invest in facilities, buildings and equipment without long-term commitments; even those firms holding existing defense contracts may be hesitant to invest for fear of program decreases or cancellation. At the same time, many firms are attempting to convert production from defense products to commercial products. These firms will be more likely to invest in support of these initiatives over investment in defense-related facilities. In addition, competition and a lack of business have forced many contractors to reduce overhead costs. Many firms are closing, consolidating, or selling facilities, not building new ones. As the research has shown, the WGL did not meet the goal of incentivizing capital investment when the defense business was

booming during the 1980s. It is extremely unlikely the policy will encourage investment now.

E. ORGANIZATIONAL CULTURE

As discussed in Chapter III, the Federal Acquisition Regulation (FAR) indicates that profit is an essential component of Government contracts. According to the FAR, "negotiations aimed merely at reducing prices by reducing profit, without proper recognition of the function of profit, are not in the Government's interest". [Ref 6:p.15-37] Given this direction, it would follow that Government contracting officers would strive to negotiate a profit that is fair and provides proper motivation to the contractor. Comments made by survey respondents indicate otherwise.

Several respondents indicated that, in their opinion, Government COs were primarily concerned with minimization of total contract price without regard to a fair and equitable profit. Three responses in particular summarize this view:

- DoD seems to feel that profit is a dirty word.
- The basic problem with the WGL and DoD's profit policy is the basic underlying belief that profit is to be minimized vs. an incentive or motivator.
- ...minimizes contractor profit to the maximum extent possible.

In addition, several respondents indicated a belief that DoD contracting personnel utilized the WGL in a manner so as to avoid criticism or undue oversight from superiors. Two contractor comments are particularly enlightening in this regard:

- ...no Government official wants to be questioned by Congress if the profit is perceived to be too high.
- ...pity the poor CO who decides contrary to one of his "advisors" without pages of justification.

These responses seem to indicate an organizational culture within the DoD acquisition community that, regardless of FAR guidance, encourages contracting officers to attempt to minimize contract price, including profit, at all costs, and develop negotiation objectives which will please superiors, but not necessarily provide incentive to the contractor.

In light of the motivational role of profit within private industry, a goal of minimizing total contract price while seeking to incentivize efficient and effective contract performance is contradictory. As the contracting officer seeks to reduce the total price of a contract, thus reducing the compensation paid to the contractor, the amount of risk borne by the contractor increases. As risk increases, the amount of profit expected by the contractor (under the

economic theory of profit) will increase. Based on the above comments, the expected level of profit is not being provided by the Government.

On the other hand, respondent comments show a lack of concern or understanding of the CO's role as a guardian of taxpayer funds. One respondent even suggested that "...it is OK to make money, even at the taxpayer's expense". These responses suggest to the researcher a lack of perspective within the organizational culture of the defense industry. Negotiation should be a two-way process, the goal of which is to arrive at a fair and reasonable price that is mutually agreeable to both buyer and seller. Based on the research, industry expects the Government to accede to all its demands.

Despite industry's desires, contracting officers must answer to higher authority; it is probable that some COs do attempt to minimize profit, rather than negotiate a fair profit. It is the nature of Government that mistakes, perceived or actual, may result in additional oversight, Congressional action, and unfavorable press coverage. Under these pressures, the CO must balance taxpayer interests with contractor interests. Contractor negotiators must answer to higher authority as well. In the researcher's opinion, it is likely that some respondents are trying to blame Government COs' use of the WGL for less than desired profit rates.

Organizational culture within the acquisition community was recently addressed in an amendment to the FAR, the Statement of Guiding Principles for the Federal Acquisition System. This document was released by the Federal Acquisition Regulatory Council, effective 03 July 1995. Key points of interest:

...Government members of the [Acquisition] Team must be empowered to make acquisition decisions within their areas of responsibility, including selection, negotiation, and administration of contracts consistent with the Guiding Principles....The contracting officer must have the authority to the maximum extent practicable and consistent with the law, to determine the application of rules, regulations, and policies on a specific contract.

The authority to make decisions and the accountability for the decisions made will be delegated to the lowest level within the System, consistent with law. [Ref 7:pp.10-11]

If the organizational culture described by the respondents truly exists within DoD, the empowerment described by the Statement of Guiding Principles may encourage COs to negotiate profit rates without as much concern for oversight and criticism from above.

F. BIAS IN THE WEIGHTED GUIDELINES

There appears to be a perception among some respondents that the Weighted Guidelines method is biased towards large, well-established contractors. A significant number, 34.2%, indicated a belief that the WGL are biased; their comments include the following:

- Favors slightly those contractors who own their own facilities and possess highly skilled technical personnel.
- Major prime contractors with sole source contracts.
- Very large primes with significant investments in buildings, facilities, and equipment.

Based on these comments, it is reasonable to assume that this opinion would be held by subcontractors and small companies. However, of the 13 respondents who indicated a belief in WGL bias, seven were prime contractors while just six were subcontractors. Thus, many of the respondents who indicated a belief in WGL bias toward large firms are themselves large firms. It is probable that these large firms base their opinions on actual experience, though there was nothing in the comments to substantiate this. Regardless, the perception exists, at least among these firms. Additionally, of the 20 small firms (defined by the researcher as those firms with

less than 1,000 employees) responding to the survey, only six identified a belief in WGL bias. This would indicate that the majority of these small companies have experienced nothing that would lead them to believe in WGL bias toward large, or any other category of, contractors. It is interesting to note that 26.3% of total respondents failed to answer this question. It is possible that the respondents were unsure how to answer, had no strong opinion, or simply overlooked the question.

The WGL are designed to avoid bias in certain situations. When calculating the values to assign to Facilities Capital Employed for highly facilitized manufacturing firms performing research and development or services contracts, the contracting officer is provided with an alternate, lower range of values to use for Land, Buildings, and Equipment. [Ref 19:p.215.9-13] Otherwise, the values are designed to relate "the usefulness of the facilities capital to the goods or services being acquired under the prospective contract". [Ref 19:p.215.9-14] In other words, the CO will reward quality, not quantity.

It is probable that large, well-established manufacturers will have the resources necessary to acquire new equipment or state-of-the-art technology, hence gaining a competitive advantage over smaller firms. This in itself could lead some

firms to conclude that the WGL, and Government acquisition in general, may favor the larger companies. However, the goal of profit policy and the WGL is not to evaluate the capabilities of an offeror; that is the function of the source selection process. The purpose of the WGL is to permit the CO to develop a prenegotiation profit objective based on Performance Risk, Contract-type Risk, and Facilities Capital Employed. Used properly, there should be no bias towards a company simply because that company is highly facilitized.

G. USE OF WEIGHTED GUIDELINES BY INDUSTRY

As discussed above, the WGL focus on three primary factors: Performance Risk, Contract-type Risk, and Facilities Capital Employed. The research indicates that there are many other factors which influence industry's definition of a reasonable profit. Though encouraged to utilize the WGL to develop their own prenegotiation profit objectives, industry appears to find the WGL too narrow to properly address their concerns. Only 42.1% of the respondents indicated use of the WGL to prepare for negotiations with the Government. This is surprising, considering a 1989 study which noted that all 23 defense contractors surveyed used WGL "as a tool to substantiate or confirm their profit/fee objectives on

negotiated contracts". [Ref 4:p.35] Of course, in 1989 the current WGL approach was relatively new, having been implemented in August 1987. The 23 contractors cited in the 1989 study may have been testing the new WGL in order to determine its value to the negotiation process. The fact that only 42.1% of respondents in the instant research use the WGL leads the researcher to conclude that industry has determined, after the "test period", that the WGL have insufficient value to merit continued use of the method.

Of the 42.1% of respondents who use the WGL, 75% identified themselves as prime contractors. This is to be expected, since fewer subcontractors are in a position to have contracted directly with the Government. Additionally, the likelihood of a respondent using the WGL to prepare for negotiations with the Government increased as the firm's degree of sole source work increased. The majority of those using WGL, 62.5%, perform greater than 25% sole source work, with 43.75% falling between 25 and 50% sole source business. This is also expected, due to the requirements for cost analysis under most sole source contracts.

Of those respondents who use the WGL, many cited a desire to establish a common frame of reference for entering negotiations. Typical responses show this:

- This helps us understand the Government's position although we might not agree.
- ...helps understand customer's position.
- We use the approach to establish our basis for discussing our proposed profit objectives.
- Only to independently assess the Government's use of the method.

Additionally, respondents indicated a desire to improve understanding of the Government's calculations, and ensure readiness to discuss the situation. Interestingly, no respondent suggested that their use of the WGL improved the negotiation process, or led to negotiation of a higher profit rate. It seems obvious though, that a common frame of reference between both parties would benefit the discussions.

Those respondents who do not use the WGL to prepare for negotiations with the Government indicated that the method was not relevant and did not provide any value-added to the negotiation process. These comments support the researcher's opinion that many contractors believe use of the WGL to be of little or no benefit. These firms believe that the numerous other factors affecting prenegotiation profit objective render the WGL virtually useless. Also, as one contractor noted, "The Government shares their own calculations; no advantage in having our own". Some of the factors affecting industry profit objective, as cited by respondents, include:

- Our firm's profit objectives are a function of corporate profit goals. Most WGL calculations fall below these goals.
- Profit objectives...are set by management to meet shareholder return objectives.
- Based on commercial profits. WGL too limiting/myopic.
- Our profit objective is based on risk and investment.
- Management discretion based on cost of capital, unallowables and required rates of return.

All of these factors, and others listed in Chapter IV, affect the profit rate that industry requires and expects.

It seems clear that contractors will enter negotiations with their own predetermined profit objective, whether they use the WGL or not. In fact, 71% of the respondents agreed that specific contractors are out for a specific return on each contract, regardless of the WGL. The primary decision factor for use of the WGL was the desire, or lack thereof, to have a common reference point for discussions with the Government. This may lead to an unwillingness on the part of some contractors to be flexible in the negotiation of profit. If the WGL provide a profit objective which falls below the company's goals, the company obviously gains little by making this known during negotiations. It is easier for a firm to ignore the guidelines and blame any differences on the use of

the approach by the Government, rather than to admit the possibility that its own internal profit goals are unrealistic. Some firms may not have the flexibility to negotiate profit levels below certain goals. If the profit available from DoD contracts is not adequate, firms always have the option of withdrawing from the marketplace. None of the respondents said that WGL calculations are inherently wrong; the firms only said they use other means to determine profit objectives. It is possible, of course, that due to economic and competitive pressures, firms may not be willing or able to devote personnel or resources to WGL calculations. But, if the firms do not use WGL, the credibility of their arguments could be questioned.

Results of the research also show that very few of the respondents, just 18.4%, use the WGL to prepare for negotiations with other contractors. Most respondents indicated that the WGL method provides very little "value-added" to the process of negotiation with other contractors. Representative comments include:

- Normally other contractors do not use WGL. We use WGL when the prime is familiar with it and they use it.
- Not relevant.

- Serves no purpose.
- Non-negotiable.

Many respondents cited the same considerations as those who do not use WGL to prepare for negotiations with the Government, but these contractors also mentioned a preference for negotiation of profit based on industry standards, risk, level of investment, and the judgment of individual negotiators. All of these considerations are perfectly reasonable. If few firms utilize the WGL within industry, it is not a surprise that companies do not spend the time and money to use the approach. In today's commercial environment, few firms can successfully compete by spending resources on functions perceived to be of no value.

H. SUBJECTIVITY

Many respondents indicated a belief that DoD contracting officers were subjective in the use of the Weighted Guidelines. Representative comments include the following:

- WGL...is based on a very subjective evaluation of each factor.
- ...too much is left to interpretation.
- Highly interpretive, subjective.

- Obviously, there is a great deal of subjectivity in the application of the factors.

Is this a fair criticism? There is nothing in the DFARS that requires a CO to be objective. In fact, it can be argued that subjectivity is required. The CO must assign values based on his best judgment under the circumstances. Should he choose to assign an above or below normal value, he must justify this position. It is possible the respondents concerned about this issue are confusing subjectivity with a lack of fairness. The CO should, of course, be fair and unbiased when selecting WGL values. As long as use of the WGL by the Government depends on personal judgment of contracting personnel, this will be a concern for contractors. However, this may not be as large a concern as it appears. Only 21% of the respondents mentioned the issue of subjectivity in their narrative comments. These comments were divided evenly between prime contractors and subcontractors: 22.2% of subs and 20.7% of primes mentioned subjectivity. If the issue was in fact of great concern to the respondents, the researcher would have expected more to mention it. It is entirely possible that the respondents could have encountered instances where, in their opinion, the CO's use of the WGL was indeed arbitrary. Of those firms who

did mention subjectivity, none provided specific examples to support their contention.

I. GOVERNMENT PERSONNEL

Obviously, the proper use of the WGL depends heavily on the knowledge and training of the contracting officers utilizing the method. Unfortunately, based on the results of this research, many in the defense industry believe the training, knowledge and experience of Government contracting personnel is lacking:

- Only 28.9% of respondents indicated a belief that DoD contracting officers have a good understanding of how to interpret and apply the WGL.
- The majority, 57.9%, indicated frequent differences with the CO's use of the WGL and DD Form 1547.

In addition, numerous comments were made regarding Government personnel. These include:

- Provide better training to Government buyers using [the WGL].
- Top level policy:good - implementation and understanding by typical GS-11 or GS-12:poor.
- Most PCOs do not understand business and the profit motive.

- COs, in my experience, do not have a good understanding of profit.

The fact that industry frequently disagrees with the contracting officer's use of the WGL does not necessarily mean that Government contracting officers do not know how to use the guidelines. It is expected that industry representatives would desire the highest possible profit; if the CO determines an objective below the expectation, there will be disagreement. Industry's perception is supported by the findings of a report issued by the Department of Defense, Office of the Inspector General (DODIG) on 28 December 1990. In this audit report, based on a review of 150 randomly selected DD Forms 1547 amounting to \$2.3 billion, DODIG noted that:

...DoD contracting officers did not adequately document profit objectives and did not correctly prepare DD Forms 1547, Record of Weighted Guidelines Application, used to develop profit objectives. These conditions existed because of inadequate training procedures for the documentation and development of DD Form 1547 profit objectives, and because of inadequate supervisory reviews. [Ref 21:p.5]

However, DoD did not agree with these findings; while admitting some mathematical errors were made, DoD argued that

the DODIG's conclusions were based on a lack of understanding by that agency of DFARS guidance. [Ref 21:p.24]

Many respondents perceive that Government personnel do not understand the profit motive; however, no respondents provided examples of how any alleged lack of understanding of profit on the part of the CO proved a detriment to the negotiation of a fair profit. It must be remembered that the WGL provides a prenegotiation profit objective. The CO can use this objective as a starting point during negotiations. The figure provided by the WGL is only a guideline. However, the results of the survey indicate that COs may be unwilling to negotiate a profit higher than the objective obtained from the WGL. Such a stance by the CO is appropriate if, in his best judgment, a higher profit rate is not justified. But, as discussed earlier in this chapter, the DoD organizational culture must permit an environment in which the CO can negotiate profit rates higher than those generated by the WGL, if conditions warrant. DoD does not expect all of its contracting personnel to possess MBA degrees; if the WGL are used properly and supplemented by the CO's judgment, an understanding of the "profit motive" is not really required.

J. THE WEIGHTED GUIDELINES AND CONTRACT TYPE

The researcher attempted to determine the extent of industry opinion regarding the effectiveness of the WGL on various contract types. The results can be summarized as follows:

- Only 10.5% of respondents indicated the WGL are more effective when negotiating fixed-price contracts.
- Some 23.7% of respondents indicated the WGL are more effective when negotiating cost-reimbursement contracts.
- An additional 23.7% of respondents indicated that the WGL are equally effective under both contract types.
- Surprisingly, 42.1% did not answer this question.

The researcher expected a significant number of responses indicating the WGL to be more effective under cost-reimbursement contracts. Cost-reimbursement contracts are negotiated for work which is riskier than that performed under fixed-price contracts. It would seem that the negotiation of profit would be more important for riskier business. While twice as many respondents favored the use of WGL for cost contracts over fixed-price contracts, the overall numbers were lower than expected. The researcher concluded that, due to the high number of respondents who failed to answer this

question, it is likely that many of the respondents believe the WGL is not effective under any contract type. This is only a supposition on the part of the researcher, but few other conclusions can be drawn from these data.

K. INDUSTRIAL BASE CONSIDERATIONS

The FAR states that it is in the Government's best interests to use profit policy to "...maintain a viable industrial base". [Ref 6:p.15-37] However, the perception among respondents is that this goal is not being met. The vast majority of those responding, 78.9%, indicated a belief that the WGL, as a vehicle for implementation of DoD profit policy, do not provide sufficient incentive for firms to remain active members of the defense industrial base. None of the respondents believe the WGL do provide such an incentive. Few of the respondents commented on this issue directly, but some comments do relate. These include:

- DoD needs to incentivize the industrial base to perform defense work, not avoid it due to unacceptable returns.
- If a company can't make at least 10-15% profit on routine orders, it will not be able to stay in business.

In an era of declining defense budgets, it is clear that DoD cannot support the industrial base as it existed in the late 1980s, when the current profit policy was implemented. Defense firms will continue to exit the market or merge in order to survive. Some firms will go out of business. According to Paul Kaminski, Under Secretary of Defense for Acquisition and Technology,:

...the supplier base has already been reduced from approximately 120,000 to 30,000 firms, and the base is likely to shrink by another one-third before the defense drawdown is completed. [Ref 13:p.36]

DoD appears quite content to let these changes occur; in reality, DoD can probably do little to slow the process, even with the current Congress' plan to spend more on defense.

The fact that the defense budget is declining does not mean that the WGL are flawed. If COs are using the guidelines properly, developing profit objectives based on the details of each contract, and using sound judgment to negotiate profit, contractors will have little room to complain. It is probable that the respondents are blaming profit policy for the problems associated with declining defense dollars. As discussed in this chapter's section on risk and return, many respondents feel that the WGL do not provide sufficient return on investment; this factor alone could cause firms to exit the

defense market. DoD cannot support the current industrial base, regardless of profit policy. In the current environment, profit policy alone can have little impact on the viability of the industrial base. However, as mentioned above, a viable base must be maintained.

L. RESPONDENT RECOMMENDATIONS FOR IMPROVEMENT

A wide range of opinions was elicited on the subject of improving the WGL. Most responses were of a very general nature, providing few details. The results can, for the most part, be grouped into four areas: more recognition of risk and investment, less subjectivity, more use of business judgment by Government personnel, and elimination of the WGL altogether. Other comments recommended improved training for Government personnel, simplified completion of DD Form 1547, and reduction of bureaucracy. Most of these subject areas have been addressed in detail above.

A large number of respondents favored total elimination of the WGL even though no firm reasons were provided to support this recommendation. Most indicated a desire to negotiate profit, but few acknowledge that this is what occurs under the current system. The WGL provides a profit objective which is a guideline for the CO; he can then negotiate the

actual profit rate. It is probable that many firms feel the CO could be more easily "manipulated" to a higher profit level without the WGL as a guide. The frequent comments regarding subjectivity, COs' fear of criticism, and failure of WGL to properly recognize risk provide a clearer picture of industry perspective. Defense firms, based on the results of this research, hold the perception that DoD profit policy, specifically the Weighted Guidelines, is not a fair and effective means of establishing profit objective.

Why then, do firms continue to compete for defense business? It must be remembered, as discussed in Chapter II, many factors other than profit affect a company's decisions. The desire for increased market share, improved public image, benefits to commercial business, and opportunities for follow-on contracts will all affect corporate behavior. Firms, in the short run, may be willing to accept lower than desired profits if they believe they will benefit in the long run. Thus, the perception that DoD profit policy is not fair and effective may not be sufficient to dissuade firms from competing for DoD work.

M. SUMMARY

This chapter has provided a detailed analysis of the data presented in Chapter IV. The analysis can be summarized as follows:

- In general, respondents have a negative opinion of the WGL.
- The WGL do not adequately recognize risk, nor provide adequate return on investment.
- DoD's organizational culture inhibits negotiation of fair profits.
- Few firms use the WGL to prepare for negotiations with either the Government or other firms.
- The WGL provide little or no incentive for firms to remain in the defense marketplace.

The next chapter will provide the researcher's conclusions and recommendations, summarize all research questions and identify areas for further study.

VI. CONCLUSIONS AND RECOMMENDATIONS

A. INTRODUCTION

The purpose of this chapter is to present the conclusions and recommendations derived from the research, answer the primary and subsidiary research questions, and suggest areas of further research.

B. CONCLUSIONS

The conclusions are a sequence of analytically drawn findings based on the research conducted into DoD profit policy, specifically the Weighted Guidelines method of establishing profit objective. The conclusion will be cited first, followed by a justification of that conclusion.

1. Conclusion #1

The majority of defense contractors feel the Weighted Guidelines are not a fair and effective means of establishing profit objectives.

Based on the results of the research, contractors feel that the Weighted Guidelines are inflexible, subjective, potentially biased toward large firms, and should be eliminated. The policy is seen as cheap, out of date, and

lacking in recognition of basic business realities such as risk and return on investment. Clearly, in the opinion of industry, the policy as it currently exists is not satisfying the FAR goal of providing contractors with "sufficient financial rewards".

2. Conclusion #2

The Weighted Guidelines do not properly reward defense contractors for risk-taking and capital investment, nor does the policy provide contractors a reasonable return on investment.

The research shows that most defense contractors feel the Government does not properly recognize, nor emphasize, contractor risk. In the opinion of the contractors, risk should be the most significant aspect of the WGL; they feel the current WGL values available for assignment under Performance Risk and Contract-type risk are inadequate. Additionally, industry believes that DoD is unrealistic in determining reasonable rates of return. The WGL are designed to promote capital investment, yet the research shows that the WGL do not motivate industry to invest, nor reward investment when it occurs.

3. Conclusion #3

The organizational culture within the DoD acquisition community encourages contracting personnel to utilize the Weighted Guidelines in a manner so as to minimize contractor profit and avoid criticism and oversight.

The research shows that, in the opinion of the defense industry, DoD contracting officers attempt to minimize contract price, including profit, in order to avoid criticism from superiors, and prevent additional oversight. This culture disregards the motivational role of profit, and partially explains the alleged lack of adequate recognition of contractor risk as discussed above. Additionally this attitude , if it exists, contradicts FAR guidance to properly recognize the function of profit.

4. Conclusion #4

The majority of defense contractors believe the Weighted Guidelines add no value to the process of preparing for negotiations with the Government and other contractors.

The research shows that many factors affect the profit objectives determined by industry. These include corporate profit goals, shareholder return objectives, cost of capital, risk and return. In the opinion of defense contractors, the

WGL are too limiting and narrow to properly address these concerns. Additionally, the large majority of contractors develop specific profit objectives regardless of WGL calculations. Though encouraged to use the WGL to prepare for negotiations, many contractors do not find the process useful.

Those contractors who did utilize the WGL cited a desire to establish a common reference point for discussions with the Government. These contractors still develop their own profit objectives based on the factors discussed above. Few contractors use the WGL to prepare for negotiations with other contractors. Reasons cited for this include a lack of relevance and lack of use of the WGL within industry. Clearly, if industry believed the WGL were a useful tool in the calculation of profit objectives, it would be used.

5. Conclusion #5

The majority of defense contractors believe: (1) DoD contracting officers do not understand use and interpretation of the Weighted Guidelines; and (2) DoD contracting officers do not have an understanding of business and the profit motive.

The research shows that defense contractors believe the training, knowledge and experience of DoD personnel is

lacking. The industry responses show a low level of confidence in the ability of contracting officers to properly use the WGL to determine a fair profit objective, primarily due to a lack of understanding by DoD personnel of the business world.

6. Conclusion #6

DoD profit policy does not provide an incentive for contractors to remain active members of the defense industrial base.

The research shows that the current profit policy and the WGL do not provide adequate incentive for contractors to remain in the defense marketplace. There are many factors contributing to the shrinking defense industrial base, including decreased defense spending. In this environment, profit policy alone cannot ensure the maintenance of a viable industrial base. Contractors require an adequate return on investment, and if it is not provided by DoD contracts, firms will exit the marketplace or go out of business.

C. RECOMMENDATIONS

The following recommendations are provided as a result of this study:

1. Recommendation #1

A new profit study should be conducted to evaluate DoD profit policy and the Weighted Guidelines in light of the significant changes in the acquisition environment.

The last major profit study, DFAIR, was conducted ten years ago; the current WGL method was implemented over eight years ago. The world has changed dramatically in that time. The Soviet Union no longer exists, the threats to U.S. national security are unpredictable, and the roles and missions of the U.S. armed forces are in a period of change. The defense acquisition environment has changed also. The defense budget has decreased, the industrial base is shrinking, acquisition reform and streamlining continues to occupy congressional attention, and the "information superhighway" has changed the face of global competition. When 89.5% of survey respondents believe the WGL should be modified, replaced, or eliminated, a review is required. A new, comprehensive study is needed to determine if the goals and assumptions underlying the current WGL remain valid.

Any new study should include an arrangement teaming DoD and industry personnel. Industry personnel can bring insight on risk, return and sound business judgment to a review of DoD profit policy. DoD and industry must be partners in this

effort, if a new policy is to protect the interests of the taxpayer while properly motivating contractor performance and gaining credibility within the contractor community.

2. Recommendation #2

DoD must ensure that contracting officers are thoroughly trained in the use and application of the Weighted Guidelines.

It is in the best interests of DoD to ensure that contracting officers are properly trained in use and application of the WGL. As noted in this research, defense contractors believe that a lack of understanding of business and the profit motive prevents DoD contracting officers from determining reasonable profit objectives. DoD contracting officers may never have the same grasp of "business" as industry does; few DoD COs have worked in private industry. However, DoD can seek new employees with business experience, and provide opportunities for business-related education for current contracting personnel. In addition, if a new profit study is conducted as recommended above, a new WGL policy may compensate for any actual or perceived lack of business knowledge among contracting officers. The guidelines themselves will incorporate the business perspective. All

that would remain is the application of good judgment by the CO.

3. Recommendation #3

DoD contracting officers must be empowered and provided sufficient flexibility to determine reasonable profit objectives in accordance with the Statement of Guiding Principles for the Federal Acquisition System.

A frequent complaint cited by survey respondents was a organizational culture within DoD that encourages contracting officers to negotiate profit in such a manner so as to avoid criticism and oversight. The Guiding Principles encourage acquisition personnel to "exercise personal initiative and sound business judgment". While the Principles require responsibility and accountability for wise use of public resources, they also mandate empowerment, with decision-making and accountability at the lowest possible level. This culture change must be embraced throughout the acquisition system, by supervisory as well as contracting personnel. Contracting officers must feel empowered to use their judgment to make the best possible profit decision, even if that means negotiating a higher profit rate than that derived from the WGL. The WGL

are a tool; they should not be a crutch for the CO to justify his position.

4. Recommendation #4

DoD should continue to encourage contractors to utilize the Weighted Guidelines to prepare for negotiations with the Government and other contractors, while ensuring that contractors understand and are indoctrinated in use of the Weighted Guidelines.

The research shows that many contractors find the WGL irrelevant and without purpose. DoD should make every attempt to ensure that all defense contractors and subcontractors understand the WGL and the reasoning behind its use. If a new profit study is conducted, taking into account an industry perspective, contractors may be more willing to accept the WGL as a tool. DoD should also be completely open with contractors, sharing WGL calculations and the reasoning behind profit objective determinations. This will help remove some of the perceived subjectivity and bias in the WGL. In order for industry to expend the time, effort, and money to use the WGL, the guidelines must be useful and relevant.

D. RESEARCH QUESTIONS

Answers to the research questions posed in Chapter I are provided below.

1. Primary Research Question

To what extent does DoD's current profit policy, specifically the Weighted Guidelines method of determining profit objective, incentivize defense contractors to provide the most efficient and effective contract performance?

Obviously, defense firms have an incentive to compete for DoD business; otherwise, none would perform defense work. However, the research has shown that, to the majority of defense contractors, DoD profit policy and the WGL are not an incentive to provide efficient and effective contract performance. Commercial firms take many factors into consideration when performing defense work and developing internal profit objectives. The level of incentive provided by these factors, including profit, is difficult to quantify. Regardless, it is clear that DoD profit policy and the WGL alone are, in the opinion of defense contractors, not providing sufficient financial rewards.

2. Subsidiary Questions

How does the defense industry view the effectiveness of DoD profit policy?

In industry's view, DoD profit policy is out of date, irrelevant and inflexible. The majority do not feel that the current WGL are fair and effective. Contractors believe the policy does not properly reward risk and investment, does not provide sufficient return, and seeks to minimize contractor profit to the maximum extent possible.

Do defense contractors use the Weighted Guidelines method to prepare for negotiations? If not, why not?

The majority of defense contractors do not use the WGL to prepare for negotiations. Those who do use the WGL wish to establish a common frame of reference for discussions. Those contractors who do not use the method feel it adds little of value to the negotiation process.

In an era of declining defense budgets, to what extent does DoD's profit policy provide an incentive to contractors to remain an active member of the defense industrial base?

The vast majority of contractors feel the WGL provide little or no incentive to remain in the defense marketplace.

The shrinking defense budget plays a role in firms exiting the market; there is simply not enough funding available to maintain the industrial base as it existed when the current WGL were developed. Those firms attempting to remain competitive for defense contracts believe the WGL are not designed nor used to maintain a viable industrial base.

E. SUGGESTIONS FOR FURTHER RESEARCH

A study of statistical profit information in the defense industry should be conducted to compare profits earned from defense contracts with commercial contracts. The same study could examine prenegotiation profit objectives for both Government and industry, and analyze the actual profit rates negotiated. In this research, many comments were made regarding the WGL; statistical analysis could determine if these opinions are accurate.

Another interesting and useful study could provide a detailed analysis of all the factors which influence contract performance, including a review of the role of profit as an incentive. The Government presumes profit to be the primary motivator for industry. This study could determine if this is a valid assumption.

APPENDIX A. QUESTIONNAIRE

Cover letter and questionnaire on DoD profit policy and the
Weighted Guidelines

LT James P. Davis
Naval Postgraduate School
2. University Cir SGC 2657
Monterey, CA 93943-2657

Dear _____,

My name is Lieutenant Jim Davis. I am a U.S. Navy Supply Corps officer working on a Master's degree in acquisition and contracting at the Naval Postgraduate School in Monterey, California. As part of my degree requirements, I am preparing a thesis on the effectiveness of the current profit policy of the Department of Defense. The focus of my research is the use and effectiveness of the Weighted Guidelines method of determining profit (or fee) objective. Specifically, I am interested in your perspective as a member of the defense industry. To this end, I have enclosed a short survey designed to take 10 to 15 minutes to complete. It would be a great help if you could complete the survey and return it to me. For your convenience, I have enclosed a self-addressed stamped envelope. If you are unfamiliar with the Weighted Guidelines, please complete the first seven questions and the optional information at the end of the survey. If at all possible, I would ask you to return the completed survey no later than 04 September 1995.

Your responses to my survey will be totally confidential. I am the only person who will see the completed surveys, and they will be destroyed upon the completion of my research. No names of companies or individuals will appear in the thesis. Additionally, my research and the questions included in the survey do not necessarily represent the views of the Department of Defense, the U.S. Navy, or the Naval Postgraduate School.

If you have questions or comments regarding my research, please feel free to write me at the above address or contact me via my voice mail, (408) 656-2536/2537, extension 2657. Additional information can also be sent to me via Fax at (408) 656-2138. Please ensure any faxes are clearly addressed to LT Jim Davis, section MR44. I can also receive comments or responses via E-mail. My address is jpdavis@nps.navy.mil.

I want to thank you in advance for your assistance. The information you provide will be invaluable.

1. Your firm is primarily a: 34 prime contractor 11
subcontractor

2. Amount of annual business with DoD: (check one)

A. Under \$100,000 2 E. 5,000,001 - 10,000,000 6
B. 100,000 - 500,000 2 F. 10,000,001 - 50,000,000 10 C.
500,001 - 1,000,000 0 G. 50,000,001 - 100,000,000 5 D.
1,000,001 - 5,000,000 6 H. Over 100,000,000 14

3. Number of employees: (check one)

A. Under 50 4 E. 1,001 - 5,000 9
B. 50 - 100 6 F. 5,001 - 10,000 3
C. 101 - 500 11 G. Over 10,000 7
D. 501 - 1,000 5

4. Your primary Standard Industrial Classification (SIC) Code,
if known: See App. B

5. Percentage of your work which is sole source/non-
competitive: (check one)

A. Under 10% 12 C. 26 - 50% 11
B. 10 - 25% 9 D. Over 50% 11

6. What is your primary product or service? See App. B

7. Are you familiar with DoD's Weighted Guidelines and the use
of DD Form 1547? (a copy of the 1547 is attached for
reference) Yes 38 No 7

8. Does your firm use the Weighted Guidelines, including DD
Form 1547, to prepare for negotiations with the Government?
Yes 16 No 22

If yes, how does your use of the Weighted Guidelines affect
the negotiation process?

If not, why not? How does your firm establish profit
objective?

9. Does your firm use the Weighted Guidelines, including DD Form 1547, to prepare for negotiations with other contractors?

Yes 7 No 29

If not, why not?

10. Do you believe the Weighted Guidelines approach favors any particular set of contractors? Yes 13 No 15

If yes, please explain.

11. Do you believe the Weighted Guidelines approach is more effective when used to negotiate: (check one)

A. Fixed-price contracts 4 C. Equally effective in both cases 9
B. Cost-reimbursement contracts 9

Please indicate your agreement or disagreement with each of the following statements. Use the below scale and record your answer in the space provided.

1
agree

2
neutral

3
disagree

12. 2.09 DoD contracting officers have a good understanding of how to interpret and apply the Weighted Guidelines.

13. 2.33 Contractor capital investment is fairly rewarded under the Weighted Guidelines approach.

14. 2.45 The current Weighted Guidelines approach is sufficiently flexible to provide adequate profits to the majority of contractors.

15. 1.79 Negotiated contractor profits would be higher if DoD did not use the Weighted Guidelines.

16. 2.58 The range of values available for assignment by DoD contracting officers provides adequate recognition of a contractor's performance risk.

17. 1.45 I frequently have significant differences with the contracting officer's use of the Weighted Guidelines and DD Form 1547.

18. 2.18 The use and application of the DD Form 1547 is clear and understandable.

19. 2.39 The range of values available for assignment by the contracting officer provides adequate recognition of the risk to the contractor associated with various contract types.

20. 2.73 The Weighted Guidelines factors for facilities capital employed are sufficient to encourage capital investment.

21. 2.91 The Weighted Guidelines, as a vehicle for implementation of DoD's profit policy, provide sufficient incentive for contractors to remain active members of the defense industrial base.

22. 1.33 The Weighted Guidelines are used more as a crutch to justify the final negotiated price than as a tool to develop an appropriate profit objective.

23. 1.24 Regardless of the Weighted Guidelines, specific contractors are out for a specific return on each contract.

24. 2.45 The Weighted Guidelines approach is a fair and effective means of establishing profit objective.

25. Do you feel the Weighted Guidelines approach should be:
(check one)

A. Retained as is 0
B. Modified 10

C. Replaced 3
D. Eliminated 21

26. What recommendations, if any, would you make to improve the Weighted Guidelines?

27. How would you characterize DoD's profit policy, including the Weighted Guidelines and the DD Form 1547? (If desired, feel free to write directly on the attached copy of the 1547).

Please provide additional comments in the space provided below. For specific comments, indicate question number. Feel free to write on the reverse of this page or attach additional pages, if desired.

28. Are you willing to discuss your views by:

A. Phone	Yes	_____	No	_____
B. Personal interview	Yes	_____	No	_____

29. (Optional) If you answered "yes" to question #28, please provide the information requested below.

Name _____

Company _____

Address _____

Phone _____

APPENDIX B. PRODUCTS AND SERVICES

Standard Industrial Classification Codes and Respondent
Product/Service listing.

Standard Industrial Classification (SIC) codes provided by
respondents:

2892	Explosives
3410	Metal Cans
3479	Coating, Engraving and Allied Services
3484	Small Arms
3519	Internal Combustion Engines
3731	Ship Building and Repair
3764	Guided Missile and Space Vehicle Propulsion Units
3812	Search, Detection, Navigation, Guidance Equipment
5190	Miscellaneous Nondurable Goods
7699	Repair Shops and Related Services
8711	Engineering Services
8731	Commercial Physical and Biological Research

Respondent Products and Services (alphabetical order):

Aerospace and Automotive Engines
Aerospace Products
Aircraft and Aerospace Electronics
Ammunition
Ammunition Handling
Combustible Ordnance
Computers
Construction Machinery and Engines
Countermeasures
Diesel Engines
ELINT Systems
Electronics
Electronics and Electro-Optics
Electronics and Mechanical Manufacturing
Electronic Test Equipment
Engines and Engine Components
Engineering Services
Electronic Warfare
Fabricated Explosive Products
Fleet Ballistic Missile Launchers
Helicopter Manufacturing
Helicopter Research and Development
High Power Amplifiers
Inertial Navigation Computers
Infrared Imaging Cameras
Marine Machinery
Mechanical Assemblies
Military High Explosives
Munition Containers
Navigation/Guidance Equipment
Ordnance-Rocket Missile Parts
Parachute Recovery Systems
Radar Systems
Research and Development Consulting
Rocket Propulsion
Security Products
Services
Ship Construction and Repair
Small Arms
Special Operations Small Arms
Tactical Wheeled Vehicles
Weapons

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